

# **THE KENYAN REGULATION OF COMPANY DIRECTORS: AN ANALYTICAL STUDY**

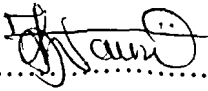
**JOSEPH KIARIE MWAURA LLB, LLM**

A thesis submitted in partial fulfilment of the requirements of the University of  
Wolverhampton for the degree of Doctor of Philosophy

February 2003

This work or any part thereof has not previously been presented in any form to the University or to any other body whether for the purposes of assessment, publication or for any other purpose (unless previously indicated). Save for any express acknowledgements, references and / or bibliographies cited in the work, I confirm that the intellectual content of the work is the result of my own efforts and of no other person.

The right of Joseph Kiarie Mwaura to be identified as the author of the work is asserted in accordance with ss.77 and 78 of the Copyright, Design and Patents Act 1988. At this date copyright is owned by the author.

Signature.....

Date.....5-2-2003

# CONTENTS

<i>Dedication</i>	vi
<i>Acknowledgements</i>	vii
<i>Table of Cases</i>	viii
<i>Table of Statutes</i>	xvii
<i>Abstract</i>	xviii

## CHAPTER ONE

### 1.0 INTRODUCTION

1.1 THE SETTING FOR THE STUDY	1
1.1.2 The Research Issues	4
1.1.3 The Aims of the Study	8
1.1.4 Contribution of the Research	9
1.1.5 Research Methodology	10
1.2 BACKGROUND	11
1.2.1 Theoretical Framework	11
1.2.1.1 Legal Contractualism	12
1.2.1.2 Economic Contractualism	12
1.2.1.3 Concession Theory	17
1.2.1.4 Communitarian Theory	17
1.2.2 Historical Framework	19
1.2.2.1 Kenya in the Pre-colonial Period	19
1.2.2.2 Reception of English Law	21
1.2.2.3 Colonial Period	23
1.2.2.4 Post-Colonial Era	25
1.3 TYPES OF COMPANIES	29
1.3.1 Companies limited by guarantee	29
1.3.2 Unlimited Companies	29
1.3.3. Companies Limited by Shares	30
1.3.4 Parastatals	30
1.3.5 Multinational Corporations	31
1.4 CONCLUSIONS	32

## CHAPTER TWO

2.0 THE ROLE OF DIRECTORS	35
2.1 INTRODUCTION	35
2.2 PARASTATALS	36

2.3 PRIVATE COMPANIES	37
2.3.1 Appointment of Directors	37
2.3.2 Restrictions on Appointment	38
2.3.3 Types of Directors	41
2.3.3.1 Alternate Directors	41
2.3.3.2 Company Chairman	42
2.3.3.3 De Facto Directors	42
2.3.3.4 Managing Director	43
2.3.3.5 Non-Executive and Executive Directors	43
2.3.3.6 Nominee Directors	44
2.3.3.7 Shadow Directors	45
2.4 POWERS OF MANAGEMENT	46
2.4.1 Division of Powers Between Members and Directors	46
2.5 RELATIONSHIP WITH THE COMPANY	50
2.5.1 Are Directors Trustees or Agents?	50
2.5.2 Power to bind the company	53
2.6 CONCLUSIONS	55
<b>CHAPTER THREE</b>	
<b>3.0 OBLIGATIONS OF COMPANY DIRECTORS</b>	<b>57</b>
3.1 INTRODUCTION	57
3.2 THE KENYAN CONTEXT	59
3.2.1 The Nature of Responsibilities	59
3.2.2 Duty to act in good faith	63
3.3.3 Exercise of power for proper purpose	65
3.3.4 Unfettered discretion	66
3.3 INTERESTS PROTECTED BY DIRECTORS	67
3.3.1 Obligations to the Corporate Entity	67
3.3.2 Directors' Responsibility to Constituents	70
3.3.2.1 Obligations to Creditors	71
3.3.2.2 Obligations to Employees	73
3.3.2.3 Donations	76
3.3.2.4 Multinational Corporations	77
3.4 CORRUPT PRACTICES	81
3.4.1 Use of a company's Property, Information or Opportunity	84
3.4.2 Competing with the company	87
3.4.3 Contracts with the company	88
3.4.4 Bribery and Gifts and other secret benefits	91
3.4.5 International Regulatory Framework	91
3.5 CONCLUSIONS	94
<b>CHAPTER FOUR</b>	
<b>4.0 THE CONDUCT OF DIRECTORS: DUTY OF SKILL AND CARE</b>	<b>97</b>
4.1 INTRODUCTION	97
4.2 THE NATURE OF THE DUTY OF SKILL AND CARE	98
4.2.1 Liability of Directors for Negligence	98
4.2.2 Origins of the Duty	99

4.3 THE STANDARD OF SKILL AND CARE REQUIRED IN KENYA	99
4.3.1 Standard of Skill and Care required in the UK	102
4.3.2 Standard of Skill and Care Required in Australia	104
4.4 STANDARD OF DILIGENCE REQUIRED IN KENYA	106
4.5 RELIANCE ON OTHERS	108
4.6 SUBJECTIVE V OBJECTIVE STANDARDS	112
4.7 CONCLUSIONS	113
<b>CHAPTER FIVE</b>	
<b>5.0 ENFORCEMENT OF LIABILITY</b>	<b>116</b>
5.1 INTRODUCTION	116
5.2 INSTITUTING PROCEEDINGS	116
5.3 RIGHTS OF SHAREHOLDERS TO SUE	122
5.3.1 Personal Rights	124
5.3.2 Fraud on the Minority	125
5.3.2.1 Control	129
5.3.3 Ratification	129
5.3.4 Statutory Protection	131
5.3.5 Inspection and Investigation	142
5.4 ENFORCING LIABILITY IN PARASTATALS	143
5.5 CONCLUSIONS	145
<b>CHAPTER SIX</b>	
<b>6.0 THE GOVERNANCE OF PARASTATALS</b>	<b>148</b>
6.1 INTRODUCTION	148
6.2 BACKGROUND	150
6.2.1 IMPACT OF PARASTATALS ON THE KENYAN ECONOMY	150
6.2.2 Development of Parastatals	152
6.2.3 Nature of Parastatals	157
6.2.4 Classification of Parastatals	157
6.2.5 The Legal Framework	158
6.3 REASONS FOR POOR PERFORMANCE	160
6.3.1 Supplementing the Private Sector	160
6.3.2 Appointment of Directors	160
6.3.3 Remuneration	164
6.3.4 Lack of Autonomy	164
6.3.5 Overlapping Regulations	168
6.3.5 Fraudulent Transactions	169
6.3.7 Conditions imposed by International Lending Agencies	170
6.4 PARASTATAL POLICY REFORM	173
6.4.1 Steps initiated by the Government	175
6.4.2 Privatisation Bottlenecks	177
6.4.3 Private Sector versus Parastatals	179
6.5 CONCLUSIONS	184
<b>CHAPTER SEVEN</b>	
<b>7.0 SELF-REGULATION OF DIRECTORS</b>	<b>186</b>
7.1 INTRODUCTION	186



7.2 BACKGROUND	188
7.3 REGULATION OF MARKET PARTICIPANTS	190
7.4 ADVANTAGES AND DISADVANTAGES OF CODES	194
7.4.1 Dispute Resolution	194
7.4.2 Good Leadership Focus	194
7.4.3 Re-awakening of Shareholders	195
7.4.4 Interface with Regulations	196
7.4.5 Flexibility	197
7.4.6 Expertise	199
7.4.7 Cost	200
7.4.8 Bias	201
7.4.9 Enforcement Problems	202
7.5 THE WAY FORWARD	203
7.6 CONCLUSIONS	206
<b>CHAPTER EIGHT</b>	
<b>8.0 DISQUALIFICATION OF COMPANY DIRECTORS</b>	<b>207</b>
8.1 INTRODUCTION	207
8.2 GROUNDS FOR DISQUALIFICATION	210
8.2.1 Bankrupts	210
8.2.2 Management of the Company	211
8.2.3 Fraud	213
8.2.4 Unfitness	216
8.2.4.1 Incompetence	218
8.2.5 Filing Returns	220
8.3 THE LENGTH OF DISQUALIFICATION ORDERS	221
8.4 PROCEDURE FOR DISQUALIFICATION	222
8.5 ENFORCEMENT OF DISQUALIFICATION ORDERS	225
8.5.1 Limited and Conditional Orders	226
8.5.2 Undertakings	227
8.5.3 Register of Disqualified Persons	227
8.6 CONCLUSIONS	228
<b>CHAPTER NINE</b>	
<b>9.0 EMPIRICAL STUDY</b>	<b>230</b>
9.1 INTRODUCTION	230
9.2 THE EMPIRICAL DATA	232
9.3 CONCLUSIONS	246
<b>CHAPTER TEN</b>	
<b>10. 0 RECOMMENDATIONS FOR REFORM</b>	<b>249</b>
10.1 INTRODUCTION	249
10.2 CODIFICATION	250
10.3 AWARENESS	251
10.4 DIRECTORS' ROLE IN SOCIAL RESPONSIBILITY	252
10.4.1 Multinational Corporations	255

10.4.2 Donations	258
10.4.3 Corruption	259
10.5 COMPETING WITH THE COMPANY	260
10.6 CONTRACTS WITH THE COMPANY	261
10.7 DUTIES OF SKILL, CARE, AND DILIGENCE	262
10.8 ENFORCEMENT OF LIABILITY	264
10.9 PARASTATALS	270
10.10 SELF REGULATION	272
10.11 DISQUALIFICATION	273
10.12 CONCLUSIONS	275
<b>CHAPTER ELEVEN</b>	<b>276</b>
<b>BIBLIOGRAPHY</b>	<b>285</b>

## **DEDICATION**

To my parents, Nyambura and Mwaura, for their interest, care, and for instilling in me the values of initiative and integrity.

## **ACKNOWLEDGEMENTS**

I am grateful to my supervisors, Professor Andrew Keay and Mr Peter Walton, for sparing time to read and comment on this thesis and for their immensely helpful advice and encouragement. I also thank the School of Legal Studies, for providing the funds and facilities which facilitated the completion of this thesis. Without the encouragement, patience, and perseverance of my wife, Waithira, this thesis would not have seen the light of day. I am grateful for her invaluable support.

## TABLE OF CASES

*AB Trucking and BAW Commercials* (Ch D June 1987, Unreported).

*Aberdeen Rly v Blaikie* (1854) 10 Macq HL 461.

*Allen v Hyatt* (1914) 30 TLR 444.

*Ashburton Oil NL v Alpha Minerals NL* (1971) 123 CLR 614.

*Atwool v Merryweather* (1867) LR 5 Eq 464.

*Australian Growth Resources Corp Pty Ltd v Van Reesema* (1988) 6 ACLC 529.

*Automatic Self-cleansing Filter Syndicate Co Ltd v Cunnninghame* [1906] 2 Ch 34.

*Awa Ltd v Daniels* (1992) 10 ACLC 933.

*Bancorp Investments Ltd v Primac Holdings Ltd* (1984) 9 ACLR 263.

*Bell v Lever Bros* [1932] AC 161.

*Bell Houses Ltd v City Wall Properties Ltd* [1966] 2 QB 656.

*Benson v Heathorn* (1842) 1 Y & CCC 326.

*Berlei Hestia (NZ) Ltd v Fernyhough* [1980] 2 NZLR 150.

*Biala Property Ltd v Mallina Holdings Ltd (No 2)* (1993) 11 ACSR 785.

*Birch v Sullivan* [1957] 1 WLR 1247.

*Bishopsgate Investment Management Ltd v Maxwell (No 2)* [1994] 1 All ER 261.

*Boardman v Phipps* [1965] Ch 992.

*Boulting v ACTT* [1963] 2 QB 606.

*Bowerman v Hammer* (1919) 250 US 504.

*Brady v Brady* (1987) 3 BCC 535.

*Breckland Group Holdings Ltd v London and Suffolk Properties Ltd* [1989] BCLC 100.

*Briess v Wolley* [1954] AC 333.

*Bugerere Coffee Growers Ltd v Sebaduka* [1970] EA 147.

*Burland v Earle* [1902] AC 83.

*Bushell v Faith* [1970] AC 1099.

*Byrne v Baker* [1964] VR 443.

*Canadian Aero Service Ltd v O'Malley* [1973] 40 DLR (3d) 371.

*Charitable Corporation v Sutton* (1742) 2 Atk 400.

*Charterbridge Corporation v Lloyds Bank Ltd* [1970] Ch 62.

*Commissioner for Corporate Affairs v Bracht* [1989] VR 821.

*Commissioner for Local Government, Lands, and Settlement v Kaderbhai* [1931] AC 652.

*Commonwealth Bank of Australia v Friedrich* (1991) 5 ACSR 115.

*Cope v Butcher* (1996) 20 ACSR 37.

*Cullerne v The London & Suburban General Permanent Building Society* (1890) 25 QBD 485.

*Cummings & Anor v Claremont Petroleum NL* (1993) 11 ACLC 125.

*Curtis's Furnishing Stores Ltd v Freedman* [1966] 2 ALL ER 955.

*Daniels v Anderson* (1995) 37 NSWLR 438.

*Dawson Print Group Ltd v Princo Ltd* (Unreported, 9 April 1986, ChD).

*Dorchester Finance Co Ltd v Stebbing* [1989] BCLC 49.

*Dovey v Covey* [1901] AC 477.

*Dowse v Marks* (1913) SR (NSW) 332.

*East African Community v R* [1970] EA 457.

*Eastern Counties Railway v Hawkes* (1885) 5 HLC 331.

*Edwards v Halliwell* [1950] 2 All ER 1064.

*Elkington & Co v Hurter* [1892] 2 Ch 452.

*Emco Plastica International Ltd v Freeberne* [1971] EA 432.

*Erlanger v New Sombrero Phosphate Co* (1878) 3 AC 1218.

*Evans v Burner Mond & Co* (1921) 1 Ch 359.

*Federal Deposit Insurance Corporation v Bierman* (1993) 2 F 3d 1424 (7th Cir).

*Federal Deposit Insurance Corporation v Stanley* (1991) 770 F Supp 1281 (ND Ind).

*Ferguson v Wilson* (1866) LR 2 Ch App 77.

*Firbank's Exors v Humphreys* [1886] 18 QBD 54.

*Flagship Carriers Ltd v Imperial Bank Ltd*, High Court of Kenya Civil Case No 1643 of 1999 (Unreported).

*Foss v Harbottle* (1843) 2 Hare 461.

*Francis v United Jersey Bank* (1981) 432 A 2d 814 (NJ).

*Fulham Football Club v Cabra Estates* [1994] 1 BCLC 363.

*GE Railway v Turner* (1872) LR 8 Ch App 149.

*Gluckstein v Barnes* (8) [1900] AC 240.

*Grant v Gold Exploration & Development* [1900] 1 QB 233.

*Greenhalgh v Arderne Cinemas* [1951] Ch 286.

*Group Four Industries Property Limited v Brosnan* (1992) 8 ACSR 468.

*Hampson v Price's Patent Candle Co* (1876) WR 754.

*Harlowe's Nominees Pty Ltd v Woodside (Lake Entrance) Oil Co* (1968) 42 ALJR 123.

*Henderson v Merret Syndicates Ltd* [1995] 2 AC 145.

*Heyting v Dupont* [1964] 2 All ER 273.

*Hirsche v Sims* [1894] AC 654.

*Hogg v Cramphorn Ltd* [1967] Ch 254.

*Howard Smith Ltd v Ampol Ltd* [1974] AC 821.

*Huckerby v Elliot* [1970] 1 All ER 189.

*Hutton v West Cork Rly*, (1883) 23 Ch D 654.

*Imperial Hydropathic Co, Blackpool v Hampson* (1882) 23 Ch D 1.

*Industrial Development Consultants Ltd v Cooley* [1972] 2 All ER 86.

*Island Export Finance Ltd v Umunna* [1986] BCLC 460.

*Jenkins v Enterprises Gold Mines NL* (1992) 6 ACSR 539.

*John Shaw and Sons (Salford) v Shaw* [1935] 2 KB 113.

*Kassam Ebrahim v Tait* [1935] EACA 51.

*Kavanaugh v Gould* (1918) 223 NY 103, 199 NE 237.

*Knight v Frost* [1999] 1 BCLC 364.

*Kuwait Asia Bank EC v National Mutual Life Nominees Ltd* [1991] 1 AC 187.

*Lagunas Nitrate Company v Lagunas Syndicate* [1899] 2 Ch 392.

*Land Credit Co of Ireland v Lord Fermoy* (1870) 5 Ch App 763.

*Leisure Lodges Limited v Yashvin A Shretta* Civil Appeal No 10 of 1997 (unreported) in Winding Up Cause No 28 of 1996 (Court of Appeal, Kenya).

*Lindgren v L & P Estates Ltd* [1968] Ch 572.

*Lister v Lamford Ice and Cold Storage Co Ltd* [1957] AC 555.

*London & Mashonaland Exploration Co. v New Mashonaland Exploration Co* (1891) WN 165.

*Lonrho Ltd v Shell Petroleum Co Ltd* [1980] 1 WLR 627.

*MacDougall v Gardiner* (1875) 1 Ch D 13.

*McMillan v Guest* [1942] AC 561.

*Marquis of Bute's Case* [1892] 2 Ch 100.

*Marshall's Valve Gear Co Ltd v Manning, Wardle & Co Ltd* [1909] 1 Ch 267.

*Medforth v Blake* [1999] All ER (D) 546.

*Menier v Hooper's Telegraph Works* (1874) 9 Ch App 350.

*Mills v Mills* (1938) 60 CLR 150.

*Mohamed Mitha and Others v Ibrahim Mitha & Others* [1967] EA 575.

*Movitex Ltd v Bulfield* (1986) 2 BCC 99.



*Mozley v Alston* (1847) 41 ER 833.

*Multinational Gas and Petroleum Co v Multinational Gas and Petroleum Services Ltd* [1983] Ch 258.

*Musa Misango v Eria Musigire & Others* [1966] EA 390.

*Neptune (Vehicle Washing Equipment) Ltd v Fitzgerald* [1966] Ch 274.

*Norman v Theodore Goddard* [1991] BCLC 1028.

*North West Transportation v Beatty* [1887] 12 AC 589.

*Nurcombe v Nurcombe* [1985] 1 WLR 370.

*Overend, Gurney & Co v Gibb* (1872) LR 5 HL 480

*Panorama Developments (Guildford) Limited v Fidelis Furnishing Fabrics Ltd* [1971] 3 WLR 440.

*Parke v Daily News Ltd* (1962) Ch 927.

*Pavlides v Jensen* [1956] Ch 565.

*Pender v Lushington* (1877) 6 ChD 70.

*Percival v Wright* [1902] 2 Ch 421.

*Permanent Building Society v Wheeler* (1993-1994) 11 WAR 187.

*Peskin v Anderson* [2000] 2 BCLC 1.

*Peso Silver Mines Ltd (NPL) v Cropper* [1966] 58 DLR 1 (2d).

*Peter G Ellis v NG Bailey & Co (East Africa) Ltd* [1962] EA 26.

*Peters American Delicacy Co v Heath* (1939) 61 CLR 457.

*Phipps v Boardman* [1967] 2 AC 46.

*Piercy v S Mills & Co Ltd* [1920] 1 Ch 77.

*Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* [1982] Ch 204.

*Queensland Mines Ltd v Hudson* (1978) 52 ALJR 379.

*R v Ivan Arthur Camps* [1962] EA 403.

*R v Campbell* [1984] BCLC 83.

*R v Kazmi* (1984) 7 Cr App Rep 115

*R v Panel on Take-overs and Mergers ex parte Guinness Plc* [1989] 1 All ER 509.

*Regal Hastings Ltd v Gulliver* [1967] 2 AC 1347.

*Re A Company No 00477 of 1986* [1986] BCLC 376.

*Re Altim Pty Ltd* [1968] 2 NSWLR 762.

*Re Arctic Engineering Ltd (No 2)* [1986] BCLC 253.

*Re Avon Chambers Ltd* [1978] 2 NZLR 638.

*Re Barings Plc (No 5)* [1999] 1 BCLC 433.

*Re Bellador Silk Ltd* [1965] 1 All ER 667.

*Re Brazilian Rubber Plantations and Estates Ltd* [1911] 1 Ch 425.

*Re Camerons Coalbrook Steam Coal, and Swansea and Lougher Railway Co, Bennet's Case* (1854) 5 De GM and G 284

*Re Cardiff Savings Bank* [1892] 2 Ch 100.

*Re City Equitable Fire Insurance Co* [1925] Ch 407.

*Re Clasper Group Services Ltd* [1989] BCLC 143.

*Re Continental Assurance Co of London Plc* [1996] BCC 888.

*Re Denham & Co* (1884) 25 Ch D 752.

*Re D'Jan of London Ltd* [1993] BCC 646.

*Re Douglas Construction* (1988) 4 BCC 553.

*Re Empress Engineering Co* (1880), 16 Ch D 125.

*Re Eryeza Bwambale & Co Ltd* [1969] EA430.

*Re Forest of Dean Coal Mining Company* (1878) 10 Ch D 450.

*Re Gee & Co (Woolwich) Ltd* [1972] 2 WLR 515.

*Re Grayan Building Services Ltd* [1995] BCC 554.

*Re Hammer Ltd* (1958) 3 All ER 689.

*Re The Highlands Commercial Union Limited* [1957] EA 851.

*Re Horsley & Weight Ltd* [1982] Ch 442.

*Re Hydrodam (Corby) Ltd* [1994] 2 BCLC 183.

*Re Ipcon Fashions Ltd* (1989) 5 BCC 733.

*Re Jermyn Street Turkish Baths Ltd* (1970) 3 All ER 57.

*Re Kaytech International Plc Portier v Secretary of State for Trade and Industry* [1999] BCC 390.

*Re Lands Allotment Co* [1894] 1 Ch 617.

*Re Lee, Behrens and Co Ltd* [1932] 2 Ch 46.

*Re Leomond Properties Pty Ltd* (1983) 1 ACLC 1370.

*Re Living Images Ltd* [1996] 1 BCLC 348.

*Re Lo-Line Electric Motors Ltd* [1988] 3 WLR 26

*Re Lundie* (1965) 2 ER 692.

*Re Magna Alloys & Research Pty Ltd* (1974-76) 1 ACLR 203

*Re Majestic Studios* [1989] BCLC 1.

*Re McNulty's Interchange Ltd* (1988) 4 BCC 533.

*Re Minimix Industries Ltd* (1982) 1 ACLC 511.

*Re Moorgate Metals Ltd* [1995] 1 BCLC 503.

*Re Polly Peck International Plc (No 2)* [1994] 1 BCLC 574.

*Re National Bank of Wales Ltd* [1899] 2 Ch 629.

*Re RA Noble & Sons (Clothing) Ltd* [1983] BCLC 273.

*Re Richborough Furniture* [1996] 1 BCLC 507.

*Re Rolus Properties Ltd & Another* (1988) 4 BCC 446.

*Re Sevenoaks Stationers Retail Ltd* [1991] Ch 164.

*Re Smith v Fawcett Ltd* [1942] Ch 304.

*Re Stanford Services* [1987] BCLC 607.

*Re Tasbian Ltd (No 3)* [1992] BCC 358.

*Re The Highlands Commercial Union Limited* [1957] EA 851.

*Re Union Carbide Corporation Gas Plant Disaster at Bhopal, India in December 1984* MDL Docket No 626, US District Court, Southern District of New York, Ordered November 8, 1985.

*Re Unisoft Group Ltd (No 3)* [1994] 1 BCLC 609.

*Re W & M Roith Ltd* [1967] 1 WLR 443.

*Re Westmind Packing Services Ltd* [1983] Ch 258.

*Reading v Att-Gen* [1951] AC 507.

*Richard Brady Franks Ltd v Price* (1937) 58 CLR 112.

*Ring v Sutton* (1980) 5 ACLR 546.

*Royal British Bank v Turquand* [1856] All ER 435.

*Salford Corporation v Lever* [1891] 1 QB 168.

*Secretary of State for Trade and Industry v Deverell* [2000] 2 WLR 907.

*Selangor United Rubber Estates Ltd v Cradock (No 3)* [1968] 1 WLR 1555.

*Scott v Scott* [1943] 1 All ER 582.

*Scottish Competitive Co-operative Wholesale Society Ltd v Meyer* [1959] AC 324.

*Scottish CWS Ltd v Meyer* [1958] 3 All ER 66.

*Shuttleworth v Cox Brothers and Co (Maidenhead) Ltd* [1927] 2 KB 9.

*Simpson v Westminster Palace Hotel Co* (1860) 2 LT 707.

*Smith v Croft (No 2)* [1988] Ch 114.

*Spokes v Grosvenor Hotel Co* [1897] 2 QB 124.

*Statewide Tobacco Services Ltd v Morley* (1990) 2 ACSR 405.

*Sverre Haug and Others v Buhemba Mines* (1953) 20 EACA 28

*Taylor v NUM (Derbyshire Area)* [1985] BCLC 237.

*The Commissioner General of Income Tax v Ivory Safaris Ltd* [1972] High Court of Kenya Civil Appeal No 113 of 1971.

*Theodore Goddard* [1992] BCC 14.

*Thomas v HW Thomas Ltd* [1984] 1 NZLR 686.

*Thorby v Goldberg* (1964) 112 CLR 597.

*Trevor Price and Another v Raymond Kelsall* [1957] EA 752.

*Tomkinson v South-Eastern Railway Co* (1887) 35 Ch D 675.

*Towers v African Tug* [1904] 1 Ch 558.

*Transvaal Lands Co v New Belgium (Transvaal) Land and Development Co* [1914] 2 Ch 488.

*Vrisakis v Australian Securities Commission* (1993) 1 WAR 395.

*Wallersteiner v Moir* (No 2) [1975] QB 373.

*Walker v Wimborne* (1976) 50 ALJR 446.

*Whitehouse v Carlton Hotel Pty Ltd* (1987) 162 CLR 285.

*Whitwam v Watkin* (1898) 78 LT 188.

*Wilson v Brett* (1843) 11 M & W 113.

*York and North Midland Rly V Hudson* (1853) 16 Beav 485.

*Zephrine Simon Muchunguzi and Others v Geoffrey Makana Asayo* Civil Application No NAI 316 of 1997 (Unreported), 16th January 1998, (Court of Appeal).

## **TABLE OF STATUTES**

Companies Act 1948 (UK).

Companies Act 1962, Cap 486, Laws of Kenya.

Companies Act 1985 (UK).

Companies Act 1989 (UK).

Companies Act 1993 (New Zealand).

Company Directors Disqualification Act 1986 (UK).

Corporations Act 2001 (Australia).

Financial Services Act 1986 (UK).

Insolvency Act 1986 (UK).

Political Parties, Elections and Referendums Act 2000 (UK).

Prevention of Corruption Act, Cap 65, Laws of Kenya.

Supply of Goods and Services Act 1982 (UK).

The Employment Act, Cap 226, Laws of Kenya.

The Employment of Women, Young Persons and Children Act, Cap 227, Laws of Kenya.

The Factories Act, Cap 514, Laws of Kenya.

The Regulation of Wages and Conditions of Employment Act, Cap 229, Laws of Kenya.

The Shop Hours Act, Cap 231, Laws of Kenya.

The State Corporations Act, Cap 446, Laws of Kenya.

The Workmen's Compensation Act, Cap 236, Laws of Kenya.

Trade Disputes Act, Cap 234, Laws of Kenya.

## ABSTRACT

As a former colony of the UK, Kenya inherited its current regulatory framework of directors from the UK. Since the regulatory framework was inherited, it has not been modified in any way to reflect the circumstances of the country. This thesis assesses the suitability of the current regulatory framework of directors to Kenya by examining the extent to which the regulation of directors facilitates commercial activity and enables delivery of benefits to companies. This is assessed by analysing whether:

- The rules properly regulate the key relationship between directors and shareholders.
- The rules are easy to understand.
- Important areas of general law should be codified.
- Company directors should have non-statutory guidance to their duties and responsibilities.
- Directors are properly appointed; directors have regard for their duties.
- Shareholders have adequate means of enforcing liability against miscreant directors.
- Self-regulation by directors would be effective.
- There are enough safeguards to regulate directors of parastatals.<sup>1</sup>
- The current disqualification regime in Kenya is effective.

This thesis demonstrates that the Kenyan regulatory framework relating to directors is weak, outdated, and a morass of complexity which causes much uncertainty. This thesis establishes: the objectives of commercial laws still exist from colonial times and, thus, do not conform with the present day's commercial activities; the power of

---

<sup>1</sup> Parastatals are entities earning their revenue from sale of goods and services. They have a separate legal identity with the government owning a majority equity holding. They control key sectors such as mineral and agricultural exports, transport and communications, manufacturing, and agricultural trade. See SRI International and Mwaniki Associates, *Parastatals in Kenya: Assessment of their Impact and an Action Plan for Reform, Final Report*, February 1992, p 19.

shareholders to control directors is minimal; the ineffectiveness of local and international regulatory framework of directors has affected the performance of companies; corruption affects the well-being of both corporate entities and the economy of the country; the application of subjective rather than objective standards to assess the liability of directors is ineffective; the corporate and collective nature of the company makes it difficult for shareholders to enforce liability against errant directors; that parastatals have performed poorly due to inadequate managerial performance of directors; the disqualification regime needs to be more stringent in order to deter miscreant directors.

It is the contention of this thesis that reforms of the current regulations are required in order to achieve a framework which is modern, effective, transparent, straightforward and easy to understand. Whilst it seeks to make recommendations for a regulatory framework tailored to local circumstances, it also draws from developments in the UK and other Commonwealth countries, which would facilitate enterprise, fair dealing, accountability, balance the interests of business with those of shareholders and stakeholders, and contribute to the growth of the national economy.

Chapter One briefly traces the development of the Kenyan economy from the pre-colonial to post-colonial period and outlines the origins of company law in Kenya. It seeks to assess whether the objectives of commercial laws during colonial times are relevant to the present day. It also analyses the theoretical framework of companies with a view to establishing what objectives companies ought to serve.

Chapter Two examines the place of a director in a company. It addresses the procedural requirements for appointments and the relationship of directors with shareholders. It also considers how the autonomy enjoyed by directors of private companies differs from that of directors of parastatals, which are corporations owned and largely controlled by the State. The chapter shows that the autonomy of the board enables it to make sound decisions on behalf of the company. However, because the autonomy of the board of directors may sometimes be abused by miscreant directors, the chapter analyses how the law regards directors as trustees or agents of the company with a view to curbing abuse of their duties and responsibility to the company.



Chapter Three considers the obligations owed by directors to the corporate entity, creditors, and other constituent groups. Although shareholders expect directors to maximise their profits, this chapter shows that acting in the best interests of the corporate entity alone can have detrimental effects on the profitability of a company. This is because the failure to assume social responsibilities may have adverse effects on good customer relations and the well being of the national economy.

The fourth chapter analyses the duties of care and skill owed by directors and assesses their effectiveness. The chapter shows how the application of the subjective standards of skill and care in Kenya enable directors to escape liability for misconduct. It also examines the need to raise the standards of skill and care because shareholders are not in a position to track continuously the conduct of directors.

Chapter Five analyses the ability of shareholders to enforce responsibilities owed to companies by their directors. It shows how the Kenyan courts deprive both the minority investors and the company of their rightful profits by failing to intervene in the internal management of companies. The chapter demonstrates the need to strike a balance between excessive regulation or control by the courts and lack of sufficient control or judicial intervention in the internal management of companies. It is argued in the chapter that the willingness of the courts to interfere in the internal management of companies, where necessary, could promote the confidence of investors, as they would be assured of effective monitoring of directorial activities.

Chapter Six assesses the extent to which the poor performance of parastatals can be attributed to poor performance by directors. It shows how the operation of parastatals is affected by overlapping regulations, political control and appointment of directors, their role in supplementing the private sector, poor remuneration, and the policies of international lending agencies. The chapter also addresses the effectiveness of some reform measures, such as privatisation, which have been adopted by the government to make parastatals profitable.

Chapter Seven considers self-regulation by directors and examines whether it would be viable in Kenya. It explores whether self-regulation has some distinct advantages

over statutory regulation. It also considers how effective it would be in reducing interference of the government in the market and the reluctance to punish miscreant directors. The chapter explores the measures that might be adopted in Kenya to make self-regulation by directors effective.

Chapter Eight analyses the disqualification regime and measures its effectiveness. It shows that the practical consequences of disqualification provisions in Kenya are limited and, therefore, do little to raise standards of the conduct of directors and to protect the public from miscreant directors. The chapter assesses how shareholders and creditors can be protected by broadening the scope of provisions, offences, and grounds covered by the Act.

Chapter Nine analyses the results from a survey which was conducted between October 2001 and January 2002 in Nairobi. The survey was conducted with a view to establishing what aspects of the legal framework in Kenya need to be changed.

Chapter Ten makes recommendations for reform. It examines the extent to which the codification of the duties of directors and other provisions would simplify legal requirements and, thus, allow directors and the stakeholders of the company to understand more easily the duties and responsibilities of directors.

Chapter Eleven offers some concluding remarks.

## CHAPTER ONE

### 1.0 INTRODUCTION

#### 1.1 The Setting for the Study

Companies comprise one of the many mechanisms that the "government encourages and employs as a means for promoting the participation of citizens in the economic development of Kenya."<sup>1</sup> Given that a limited liability company enables capital to be accumulated and invested in risk-taking enterprises, companies create wealth and, in turn, contribute to the expansion of the economy, provision of jobs, and production of goods and services.

Given that the global economy is increasingly becoming integrated and interdependent, competition and high standards of conducting business<sup>2</sup> are increasingly demanding more input from company directors. As a result, the initiatives adopted by the government to regulate business determines the success of companies. For a country to draw economic benefits from the global system, the legal regulatory framework has to conform to international commercial standards<sup>3</sup> in order "to create conditions in which people can take advantage of the opportunities and challenges of globalisation."<sup>4</sup> The creation of a conducive environment attracts

---

<sup>1</sup> Hon T Mboya, "The Role of the Private Sector in Kenya National Development", in PA Thomas, *Private Enterprise and the East African Company*, (Tanzania Publishing House, 1969) p 195.

<sup>2</sup> The media and customers pressure on Shell's attempt to dispose of the redundant Brent Spar oil in Mid -Atlantic compelled the company to dispose of the structure in a way that was much more expensive than its original proposals. See Bamford, "Directors' Duties: The Public Dimension", [2000] 2 Co Law 38.

<sup>3</sup> A comparison of Kenya and Malaysia provides a good illustration of the effect that response to the global economy can have on a country. In spite of the two countries obtaining independence in 1963 with roughly the same per capita income, Malaysia has become one of the Asian Tiger economies due to implementation of policies while living standards in Kenya have hardly changed since independence. See James, "Connecting to the Global Economy Through the World Trading System" [2000] Sep-Dec, *Professional Management Journal of the Institute of Certified Public Secretaries of Kenya*, at 10.

<sup>4</sup> Ibid at 24.

both foreign and local investors<sup>5</sup> since investments can hardly be made “where there are no prospects for reasonable return in a stable and predictable environment.”<sup>6</sup>

Since independence, the Kenyan government has adopted various functions to promote private enterprise. These include:

"Assisting in identification of opportunities for private investment; stimulating the application of foreign and domestic capital, knowledge and skills to these opportunities; and enforcing an income policy, which prevents exploitation and provides adequate incentives to all that participate in the production process."<sup>7</sup>

Despite these measures, the number of companies becoming insolvent in the recent past and those avoiding the Kenyan market has increased. For instance, Vodafone Airtouch only agreed to enter into the Kenyan market<sup>8</sup> after its commercial partner, Safaricom Kenya, was exempted from the State Corporations Act.<sup>9</sup> Companies avoiding the Kenya market tend to favour doing business in countries such as South Africa due to a more favourable framework regulating directors and companies generally.<sup>10</sup> The consequences of this trend in relation to the Kenyan economy have reached alarming proportions.<sup>11</sup> There is abundant evidence, however, which shows that with prudent management of the affairs of the corporate bodies by directors, the failure of some of the institutions could have been averted. In fact, in nearly all the

---

<sup>5</sup> Foreign investments bring in capital, new technology, quality products and also make a strong contribution to growth, implementations, exports, and government revenue. Similarly, domestic investment helps in mobilising Kenya's own internal resources. See Ibid at 25.

<sup>6</sup> Ibid at 25.

<sup>7</sup> Hon T Mboya, op cit n 1, p 196.

<sup>8</sup> Vodafone Airtouch observed that the current legislation would hamper its effectiveness as a commercial partner of Safaricom Kenya. See Kiseri, "Vodafone's Bid for Shares in Safaricom Still Unclear", *Daily Nation*, 4 April, 2000.

<sup>9</sup> Cap 446, Laws of Kenya.

<sup>10</sup> A survey conducted by the International Chamber of Commerce indicated that foreign ventures by multinational corporations are likely to increase in Africa in the next three to five years. It noted that some of the most favoured markets were South Africa, Egypt, Morocco, Uganda and Nigeria. See Kassir, "Private Sector Growth is Good News out of Africa", *Journal of Commerce*, 23 March 2000.

<sup>11</sup> Some 45 parastatals and companies in which the Government has shares have been placed in receivership since 1980. See "45 parastatals, Govt firms in receivership" *East African Standard*, July 12, 2001.

cases of commercial banks<sup>12</sup> and other companies that have gone into liquidation, shareholders and directors have emerged among the leading debtors with huge amounts of non-performing loans.

The abuse of the immense discretion entrusted to directors has occasioned prejudice to shareholders and creditors. As such, many companies and parastatals have become insolvent, such as the Kenya Co-operative Creameries (in receivership), as a result of the interests of directors conflicting with those of their companies. This has involved the making of irregular purchasing decisions in total disregard of all the rules of competitive tendering. As a consequence companies have suffered losses and this has impacted on many investors and creditors. This has caused subsequent loss to companies, and left many investors and creditors with heavy losses. Some of the factors that have contributed to breach of duties by directors are incompetence, the uncertainty of regulations, and political interference. For instance, the boards of directors, which are supposed to be the principal governing bodies of the parastatals, companies that are critical to the Kenyan economy, are usually staffed with people who have neither the professional competence nor the experience to exert any control over chief executives. Also, since the responsibility for running parastatals is shared between many people and institutions,<sup>13</sup> chief executives encounter difficulties in choosing whom to obey and to whom they should report. Moreover, being institutions that are governed by overlapping laws and regulations, the task of governing parastatals is onerous. Although each parastatal is governed according to the Act of Parliament under which it was established, they are also governed under the State Corporations Act<sup>14</sup> and through administrative circulars frequently issued by the Office of the President. This makes it difficult to enforce accountability of officers in parastatals.

The mismanagement of companies has contributed to misuse of resources and hindered the in-flow and out-flow of investment funds. This has in turn negatively

---

<sup>12</sup> Owners and directors of banks are usually the main depositors, the major borrowers and, at the same time full time executives.

<sup>13</sup> People and institutions with such responsibilities include: permanent secretaries, ministers, board of directors, the Treasury, and the Office of the President.

<sup>14</sup> The Act attempts to bring all corporations under one uniform law.

affected “the production of goods and services, employment trends and therefore the standard of living of Kenyans.”<sup>15</sup>

Since directors have imposed on them duties of competently managing companies, without taking undue advantage of their positions, they share heavy responsibilities to shareholders, creditors, employees, customers, and the community. For instance, they must act swiftly in using company resources profitably, maintaining proper financial controls, ensuring payment to creditors, and above all initiating a good working relationships with employees, regulators of the market, and the government.

Although investors in a company can influence its affairs by voting at general meetings, their powers of controlling directors and their actions are limited, as most powers of the company are vested in the board of directors.<sup>16</sup> Therefore, since shareholders and other stakeholders are not in a position to keep track continuously of the activities of directors, an effective regulatory framework is needed in order to prevent errant directors from benefiting from their misconduct or causing loss to companies by their incompetent activity.

It is against the background of the importance of companies in the national economy and the crucial role played by directors in companies that this thesis intends to analyse those aspects of Kenyan company law which affect company directors and to make recommendations for reforms of the regulatory framework that purports to regulate directors.

### **1.1.2 The Research Issues**

As a former British colony, Kenya's current regulatory framework of directors, and company law as a whole, was inherited. The Companies Act 1962<sup>17</sup> (the “Act”)

---

<sup>15</sup> K Kibwana et al, *The Anatomy of Corruption in Kenya: Legal, Political and Socio-Economic Perspectives* (Nairobi: Claripress, 1996) p 5.

<sup>16</sup> The immense powers of directors are exercised either directly or through appointees, such as managers or otherwise. Duties owed by directors to the company also apply equally to any officer of the company who is authorised to act on its behalf. See *Bell v Lever Bros* [1932] AC 161, (HL). Although employees owe similar duties of fidelity, theirs, unlike those of directors, are dependent on the contract of employment. See *Reading v Att-Gen* [1951] AC 507, (HL). Also see PL Davies, *Gower's Principles of Modern Company Law*, (Sixth Edition, Sweet & Maxwell, 1997), p 598.

<sup>17</sup> Cap 486, Laws of Kenya.

and the State Corporations Act<sup>18</sup> are the basic statutes governing corporate operations in Kenya. The Act regulates ordinary companies and the State Corporations Act governs parastatals in which the government has controlling equity interests. Under the State Corporations Act, a parastatal can be established as either a statutory corporation or an ordinary company. Although a statutory corporation is established as a body corporate, it is not registered under the Companies Act 1962. A parastatal registered under the Companies Act 1962 is subject to it to the extent that it does not conflict with the State Corporations Act.

The Companies Act is based almost entirely on the UK Companies Act 1948. The UK Act was introduced in Kenya in 1959 and adopted in 1962 virtually verbatim. Despite significant changes in the UK Companies Act since 1948 and substantial economic development in Kenya since 1962, the current regulatory framework applying to directors remains as it was in 1962. This has in turn affected the competitiveness of the Kenyan economy. For example, the Nairobi Stock Exchange's Chief Executive in February 2000 attributed the failure to implement a Central Depository System to the absence of enabling legislation to make it work. He observed that putting in place the system would attract foreign investors, as it would eliminate paperwork in the transfer of ownership of the share certificate as evidence of title. As will be seen, the current framework has become seriously outdated in key respects.

The duties of directors in Kenya are not codified in the Act. The principles underlying them are found in the common law that is largely inherited from England. These principles are applicable in Kenya by virtue of the Judicature Act, which stipulates, *inter alia*, that:

“The jurisdiction of the High Court and of all subordinate courts shall be exercised in conformity with...the substance of the common law, the doctrines of equity and the statutes of general application in force in England on the 12<sup>th</sup> August

---

<sup>18</sup>Ibid. The Act was enacted following the recommendations made by the Report and Recommendations of the (Philip Ndegwa) Committee on Review of Statutory Boards, Republic of Kenya, May 1979, 19, para 81.

1897, and the procedure and practice observed in courts of Justice in England at that date: Provided that the said common law, doctrines of equity and statutes of general application shall apply so far only as the circumstances of Kenya and its inhabitants permit and subject to such qualifications as those circumstances may render necessary.”<sup>19</sup>

Whilst decisions of English courts given after the reception date are not of binding authority in Kenyan courts, they are entitled to the highest respect if the English law has not been subsequently modified.<sup>20</sup> Therefore, the current English judicial pronouncements on company law are highly persuasive in interpreting the Kenyan provisions.

Although there has been very little effort by the legislature to amend the Act in order to make it more meaningful to Kenyan needs, it is noteworthy that a task force on Companies, Partnerships and Insolvency was constituted by the office of the Attorney General on 13<sup>th</sup> August 1993. Its terms of reference were, first, to review the law governing Companies, Partnerships and their operations; second, to review the laws relating to insolvency, liquidations, and receiverships; third, to make such further recommendations incidental to the foregoing as they may deem necessary. The task force has neither made significant proposals nor submitted a final report.<sup>21</sup> The lack of action is illustrative of inertia in the corporate field which has apparently been encouraged by the Government. Although there has been no official explanation for the delay, political pressure against enacting a restrictive statute cannot be ruled out because directors of key companies are influential politicians and civil servants who appear to use their positions to benefit fraudulently from companies.<sup>22</sup>

---

<sup>19</sup> Section 3-(1) (c), Cap 8 of the Laws of Kenya.

<sup>20</sup> Ibid.

<sup>21</sup> Hon Amos Wako, AG, "On Constitutional Review", [1998] Nov-Dec *Professional Management Journal of the Institute of Certified Public Secretaries of Kenya*, 5 at 7.

<sup>22</sup> Onyango, "Super Rich Government Employees", *Daily Nation*, 9 June, 2002.



The current regulatory framework for directors has multiple flaws which impinge upon standards of corporate governance. These flaws affect the ability of companies to contribute positively to the Kenyan economy. For instance, lack of codification makes it cumbersome for directors to know what is expected of them when the provisions of the Act are uncertain and insufficient. It is even more difficult for directors with limited knowledge to comprehend their legal requirements.

The task of ascertaining in whose interests directors are supposed to act is also rendered difficult by lack of codification. Although common law rules require a director to act in the best interests of the company, a director, who takes into consideration the interests of employees in order to promote the long-term interests of a company, would not easily establish the legality of his actions.

Although the complexity of the business environment makes it difficult for shareholders to track the conduct of directors, the Kenyan Parliament and the courts have not played an active role in protecting shareholders. It is possible for directors to go unpunished as a result of negligence arising from their ignorance or inexperience.<sup>23</sup> The Kenyan Parliament and the courts have also not provided an efficient dispute resolution mechanism that encourages shareholders to enforce the liability of directors more readily. Although the State might be reluctant to enforce strictly the liability of directors, it is doubtful whether directors would be able to control themselves effectively if a self-regulatory mechanism was in place.

The Government also fails to offer adequate protection to shareholders and other stakeholders by failing to implement an effective mechanism for disqualifying miscreant directors. This leads to low levels of responsibility and accountability of directors.

The role of the Kenyan Government in running parastatals has been largely ineffective. The failure to have adequate management controls in parastatals has been

---

<sup>23</sup>The courts assess their liability subjectively. See *Flagship Carriers Ltd v Imperial Bank Ltd*, High Court Civil Case No 1643 of 1999 (Unreported), Ruling per PJS Hewett at 11. Mr Hewett relied on the rules laid down in Charlesworth & Morse, *Company Law*, (9<sup>th</sup> edition, Sweet & Maxwell, 1968), 277. The rules were originally formulated by Romer J in *Re City Equitable Fire Insurance Co* (1925) Ch 407.

caused by the politicisation of the appointment of directors by the State Corporations Act.<sup>24</sup> This causes directors to act in the interests of their appointors rather than the corporation. The boards of directors can be made effective by giving autonomy to the board by separating the State from parastatals.

Levels of the accountability and responsibility of directors may be raised by reforming specific provisions of the Companies Act and the environment within which companies operate.

Given that the outdated nature of the regulatory framework of directors continues to affect standards of corporate governance and the economy of Kenya, the research question for this thesis is: “what are the factors that impinge upon the performance of directors and what reforms can be adopted to improve standards of corporate governance?”

### ***1.1.3 The Aims of the Study***

The increase in the number of companies becoming insolvent, the avoidance of the Kenyan market by companies, the outdated nature of the Kenyan regulatory framework for directors, and the control exerted on directors of parastatals by the executive call for the review of the existing law.

Therefore, the central aims of this thesis are to provide an analysis of the Kenyan law as it affects directors and the way they are regulated. A supplementary aim is to recommend appropriate reforms of the current regulatory framework relating to directors. All of this is designed to produce a regulatory framework which would:

- Identify standards of good practice in the management of companies.
- Restrict the unlawful activities of directors and remove the unfit ones.
- Give directors room to work without unnecessary interference from other stakeholders.
- Protect the interests of all the stakeholders in the company.
- Be modern, effective, and easy to understand.

---

<sup>24</sup> Cap 446, Laws of Kenya.

- Reverse the upward trend of the number of companies becoming insolvent.
- Facilitate commercial activity and therefore encourage economic growth, investment and stability in Kenya.
- Provide incentives to both local and foreign investors for establishing business in Kenya.

Although this thesis aims at developing a regulatory framework tailored to the local circumstances, it will draw from the rich experience of the UK judiciary, in light of the strong historical links between Kenya and the UK. Thus, analogically and comparatively, English company law will be referred to and examined, as will the law of other Commonwealth countries, such as Australia, New Zealand, Nigeria, and Ghana.

#### ***1.1.4 Contribution of the Research***

The need for this research was partly triggered by the realisation that there is at present no comprehensive analysis of Kenyan company law. Moreover, there is no significant research, save for a few non-comprehensive undergraduate dissertations at the University of Nairobi, that has been undertaken to establish or make recommendations for an effective regulatory framework for directors in Kenya. The lack of research in this area could be attributed to the country's past political set up, which might have posed risk to anyone exposing sensitive political issues. Given that there is also a paucity of case law in this area, newspaper sources have been used on a number of occasions to illustrate what is going on. Undoubtedly, lack of sufficient case law and research has contributed to the existence of low standards of corporate governance.<sup>25</sup> Given that gaps in this body of knowledge continue to affect the standards of corporate governance, and in turn the economy, it is felt that this lacuna warrants this research.

A further justification for this research is the establishment of a task force on Companies, Partnerships, and Insolvency law to review the law governing

---

<sup>25</sup> The respect of individual freedoms has improved since 1990 when the country became a multiparty state.

companies, partnership, and their operations. This action is illustrative of the dire need to review company law in Kenya.<sup>26</sup>

Since this study scrutinises English principles of company law applicable in Kenya, but uses the Kenyan circumstances, needs, interests, and experiences to measure their effectiveness, it assists in producing rules, which are suitable for Kenya. The law applicable in the UK<sup>27</sup> would not necessarily be suitable for Kenya because of the differing economic conditions and policies in the two countries. Besides, the nature and size of business transacted by the two countries are different,<sup>28</sup> the people in both countries whom company law seeks to protect have different standards of sophistication and education. Moreover, the need to reflect EC directives adopted under the EC Company Law harmonisation programme has changed the direction of some parts of the UK legislation.<sup>29</sup>

### **1.1.5 Research Methodology**

The research methodology adopted in this thesis is primarily doctrinal combined with a review of the relevant theoretical literature and some significant empirical research. The empirical research was conducted by use of a survey that was undertaken between October 2001 and January 2002 in Nairobi. The data was collected through questionnaires and interviews. A questionnaire was sent in October 2001 to 200 individuals who comprised of directors, advocates, company secretaries, officials from the Attorney General Chambers and the Nairobi Stock Exchange, company secretaries, auditors, academics, and Members of Parliament. Ten individuals were also interviewed in Kenya between January 7 and January 25, 2002. Analysis of the data obtained is contained in Chapter Nine. The survey sought to establish whether aspects of the legal framework in Kenya need to be changed and, if so, in what manner. It also sought to establish the main factors that have contributed to their poor performance and investor avoidance of the Kenyan market. In addition,

---

<sup>26</sup> Hon Amos Wako, op cit n 21, at 7.

<sup>27</sup> Recent reviews of the companies' legislation have refused to follow UK's framework. Such reviews have been carried out in Nigeria, Ghana, South Africa, Australia, Canada, New Zealand, and Hong Kong.

<sup>28</sup> The presence of parastatals in Kenya is a striking difference.

<sup>29</sup> Given that continental European traditions are more prescriptive and regulatory than the UK's, UK law has adopted a different approach as a result of harmonisation. See The Company Law Review Steering Group, *Modern Company Law for a competitive Economy: The Strategic Framework*, February 1999 p 10.

it sought to establish whether the regulatory framework for directors protects the interests of shareholders, is restrictive on the unlawful activities of directors, and whether it offers adequate incentives to investors.

It was considered important to undertake this research because it appears that there has been no such research previously conducted. The survey has identified problems in the regulatory framework for directors. It has also indicated possible measures that would, if adopted, facilitate commercial activity and therefore encourage economic growth, investment, and stability in Kenya. The data obtained from the survey appears to have opened up whole new areas for research, which will be of interest to lawyers, company directors, company secretaries, auditors, and policy makers in general.

Before examining specific regulatory factors that impinge upon the performance of directors, it is important to analyse the theoretical framework of company law, the historical perspectives of the country's economy, and the types of companies in Kenya. This will validate the ideas discussed in this thesis and bring to the fore any factors that might have contributed to the present undesirable trends of corporate governance.

## **1.2 Background**

### **1.2.1 Theoretical Framework**

Analysts have often disagreed on whether a company is a private or a public creation. Those who deem a company to be a private creation maintain that companies are governed by the private law of contract.<sup>30</sup> Contractualists argue that because companies are a private matter, the intervention of government through regulation should be minimal. On the other hand, concession and communitarian theorists argue that the company is a creation of the State and is therefore governed by public law and regulation. The following section analyses theories that seek to explain the functions of a company.

---

<sup>30</sup> M Jensen and W Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure", (1976) 3 *Journal of Financial Economics* 305.

### **1.2.1.1 Legal Contractualism**

Legally, the company is a distinct entity and an artificial person. As an entity it is the company that owns the assets of the business, enforces its legal rights, and incurs full liability since the liability of members is limited. Shareholders, directors, creditors, and employees become associated with a company voluntarily.<sup>31</sup> A company can therefore be seen as a unit for all bargaining arrangements between stakeholders.

According to this theory, a company is born when two or more people enter into an agreement to carry on commercial activities. The association of individuals is characterised by contractual relations between all the participants.<sup>32</sup> As such, the relationship is governed by the constitution of the company and, in turn, the private law. According to this theory, corporate decisions and actions will be lawful if they are made in accordance with contractual terms.<sup>33</sup> As a result, the impact of the action or decision on the persons affected by them will not be relevant.<sup>34</sup> This has the effect of limiting both the need for government intervention and the imposition of social responsibility on the company.

### **1.2.1.2 Economic Contractualism**

Due to the essential role played by companies in the creation of wealth, the economic approach is readily used to examine the operation of companies. Given that economics determine whether a company becomes successful or not, a company will be profitable if there is a ready market for its products and services.<sup>35</sup> People also purchase shares on the basis of economic considerations. The prospects of the shares increasing in value attracts buyers because they are bound to derive profits. Creditors also advance monies to a company on the basis that they will charge interest and, as a result, make profits. Similarly, employees are likely to be attracted to a company that would give them better returns.

---

<sup>31</sup> BR Cheffins, *Company Law: Theory, Structure, and Operation*, (Clarendon Press: Oxford, 1997), p 32.

<sup>32</sup> S Bottomley, "Taking Corporation Law Seriously: Some Considerations for Corporate Regulation" (1990) 19 *Federal Law Review* 203.

<sup>33</sup> According to *Foss v Harbottle* (1843) 2 Hare 461, the majority decision of contractors represent the will of the corporation.

<sup>34</sup> J Dine, *Company Law*, (Sweet & Maxwell, 2001) p 20.

<sup>35</sup> BR Cheffins, *op cit* n 31, p 3.

Contractarian theorists argue against any public function of companies. The theories are based on individualist philosophy which entails “a presumption against any political action which denies or restricts anyone’s freedom in any way.”<sup>36</sup> These theories presuppose that so long as an individual uses just methods to pursue his interests he should be allowed to act freely despite the impact of his actions on others.<sup>37</sup> This therefore implies that the activities of companies that have adverse effects on the welfare of the society should not be regulated so long as companies deal fairly. The application of this theory leads to a concentration of resources in the hands of a few individuals. The resulting inequality is justified on the basis that men are inherently unequal.<sup>38</sup> Rawls has argued that the inequality may be used to benefit the least advantaged members of the society.<sup>39</sup> This is to be contrasted with the view of people such as Cohen who argues that society cannot benefit unless individuals act with an egalitarian ethic with a view to realising distributive justice.<sup>40</sup>

Contractarian theorists regard a company as a unit for all bargaining arrangements which the participants in a company seek to use with a view to maximising wealth through beneficial bargains.<sup>41</sup> According to Jensen and Meckling,<sup>42</sup> the company is a “nexus of contracts” without which it would not exist.<sup>43</sup> Neo-classical economists<sup>44</sup> argue that the entity of a company reduces the costs of a complex market consisting of a series of bargains, as the company provides a “standard form contract” similar to the ones the participants would have entered into if bargains were carried out on an

---

<sup>36</sup> J Raz, *The Morality of Freedom* (OUP, 1986).

<sup>37</sup> FA Hayek, *Law Legislation, and Liberty*, 2nd ed, Vol 3, *The Public Order of a Free People*, (Routledge, London, 1982) p 149. Cited in J Dine, op cit n 34, p 14.

<sup>38</sup> According to Rawls “deep inequalities...initial chances in life...are inevitable in the basic structure of any society. See J Rawls, *A Theory of Justice* (revised edition, OUP, 1999) pp 7, 10. Cited in Janet Dine, op cit n 34, p 15.

<sup>39</sup> Ibid p 16.

<sup>40</sup> G Cohen, *If You're an Egalitarian How Come You're So Rich?* (Harvard University Press, Cambridge, Mass, 2000) p 124.

<sup>41</sup> Proponents of this theory are: Coase, “The Nature of the Firm”, (1937) 4 *Economica* 386; Alchian and Demsetz, “The Production, Information Costs and Economic Organizations”, (1972) 62 *American Economic Review* 777; Jensen and Meckling, “Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure”, (1976) 3 *Journal of Financial Economics* 305; R Posner, *Economic Analysis of Law*, 3rd ed., (Little Brown, Boston, 1986); Easterbrook and Fischel, “Contract and Fiduciary Duty”, (1993) 36 *Journal of Law and Economics* 425; and D Fischel, *The Economic Structure of Company Law* (Harvard University Press, Cambridge, Mass, 1991).

<sup>42</sup> Jensen and Meckling, op cit n 30.

<sup>43</sup> Easterbrook and Fischel, “Limited Liability and the Corporation”, (1985) 52 *University of Chicago Law Review* 89. Cited in J Dine, op cit n 34, p 26.

<sup>44</sup> This term is used interchangeably with economic contractarian theorists.

individual basis.<sup>45</sup> Thus, the creation of a company reduces the number of contracts that would have been entered into. The contracts bind the participants who associate with each other with a view to performing an economic purpose. For instance, the relationship between the participants is governed by the articles of association.

Proponents of this theory do not regard shareholders as the owners of the corporation or the prime beneficiaries of the fiduciary duties of directors.<sup>46</sup> According to Fama, shareholders enter into a contract with the firm and agree to assume a risk-bearing role by investing with a view to obtaining the difference between total revenues and costs.<sup>47</sup> Apart from this role, shareholders are not required to have any other role in the firm.<sup>48</sup> Contractarians argue that shareholders do not need a role in corporate governance because they are protected by the board of directors, as an internal monitor of the actions of the managers of the company, and other external monitors, such as the stock market which facilitates the transfer of shares.<sup>49</sup> This theory wrongly assumes that directors do not manipulate transactions or conceal information which might prompt shareholders to transfer their shares. This is not true because the management can impose excessive transaction costs on persons buying shares.<sup>50</sup> It is also the case that directors can collude with auditors, as the Enron and WorldCom scandals illustrated, to manipulate financial reports of a company and, in turn, conceal vital information from shareholders.

According to contractarians, all participants in a company enter into contracts with corporate management. It is these contracts which stipulate the extent of their claims against the assets of the company. The firm is, therefore, seen as a “nexus of contracts.” The board of directors, being the agent for shareholders, purchases managerial services and monitors the implementation of managerial policies and performances.<sup>51</sup>

---

<sup>45</sup> Coase, op cit n 41, at 386.

<sup>46</sup> Fama, “Agency Problems and the Theory of the Firm”, (1980) 88 *Journal of Political Economics* 288. Cited in Bolodeoku, “Economic Theories of the Corporation and Corporate Governance: A Critique”, [2002] JBL 411 at 426.

<sup>47</sup> Ibid at 427.

<sup>48</sup> Fama & Jensen, “Separation of Ownership and Control”, (1983) 26 *Journal of Law and Economics* 301.

<sup>49</sup> Ibid.

<sup>50</sup> Grundfest, “Just Vote No: Minimalist Strategy for Barbarians Inside the Gates”, (1994) 45 *Stanford Law Review* 857. Cited in Bolodeoku, op cit n 46, at 431.

<sup>51</sup> Fama, op cit n 48, at 433.



The role of the State is seen as an enabling one rather than regulatory. As such, company law is seen as enabling legislation which facilitates the organisation and the operation of business.<sup>52</sup> For instance, it is the function of company law to fill the gaps left by contractors who do not complete their contracts.

The relationship between the participants in a company is usually characterised by conflicts of interests. For instance, conflicts may arise whilst dividing dividends or financial losses, allocating responsibility for the performance of tasks, and determining the level of care and skill expected from directors. Contractarian theorists analyse these conflicts from an economic perspective and, thus, maintain that an agency relationship arises when one individual relies on another.<sup>53</sup> In such a scenario the person undertaking the duties is the agent and the affected party is the principal. The principal incurs agency costs when the agent fails to act in the best interests of the principal. To reduce agency costs, the principal may opt to incur monitoring costs with a view to ensuring that the agent acts in the best interests of the principal.<sup>54</sup> According to contractarians, there is an agency relationship between shareholders and directors because the principal (shareholder) engages another person (director) “to perform some services on their behalf which involves delegating some decision making authority to the agent.”<sup>55</sup> Given that shareholders rely on directors to run a company efficiently in order to derive profits, any misconduct on the part of directors imposes agency costs on shareholders.

Contractarians argue that the transactions of a company are justifiable so long as they entail efficient allocation of resources in a manner that benefits shareholders. For instance, if shareholders can benefit from a large-scale lay off of workers, the lay off would represent a more efficient allocation of resources than retention of jobs by workers. This type of efficiency, which entails that the net gain must be greater than

---

<sup>52</sup> J Ballentine, *Equity, Efficiency, and the U.S. Corporation Income Tax*, (American Institute for Public Policy Research, Washington D C, 1980), p 42. Cited in Janet Dine, op cit n 34, p 21.

<sup>53</sup> This concept is referred to as the “agency cost”. For a detailed analysis see Jensen and Meckling, op cit n 30.

<sup>54</sup> Ibid, at 308.

<sup>55</sup> Ibid.

the net loss, is referred to as Kaldor-Hicks<sup>56</sup> efficiency. It is founded on the premise that a transaction is efficient if it results in sufficient benefits to those who gain such that they can compensate the losers and still remain better off. In the event that a bargain is entered into and one person gains but no one loses the transaction is said to be Pareto efficient.<sup>57</sup> Thus, a transaction that leaves someone worse off will not be Pareto efficient, but can meet the Kaldor-Hicks standard of efficiency. Pareto efficiency is generally seen as unobtainable.

Given that the firm is seen as a nexus of contracts, and not as an individual,<sup>58</sup> contractarians take the view that the firm cannot be regarded as a person with “motivations and intentions.” As such, the firm should not be expected to have a social responsibility in same way would an individual.

Although stakeholders may suffer as a result of maximisation of the wealth of shareholders, contractarian theories do not regard that as a sufficient basis for affording legal protection because the parties can protect themselves through contracts.<sup>59</sup> Economic contractarian theory does not recognise the inequality of the bargaining power between the rational economic actors within a company. For instance, it assumes that employees are in a position to bargain fairly with a company. But there are flaws in such a view. For instance, it is doubtful whether health and safety of employees would be safeguarded without the regulation of the State. The theory does not either recognise the inability of shareholders to control directors and the need for state regulation to protect shareholders. It wrongly assumes that investors are always in a position to oust the management and seek to obtain the control of the board of directors.<sup>60</sup>

---

<sup>56</sup> Kaldor, “Welfare Propositions of Economics and Interpersonal Comparisons of Utility”, (1939) 49 *Economic Journal* 549 and Hicks, “The Valuation of the Social Income”, (1940) 7 *Economica* 105.

<sup>57</sup> The theory was named after the originator, Mr Vilfredo Pareto, who was a 19th Century Italian economist. See BR Cheffins, op cit n 31, p 14.

<sup>58</sup> Contractarians define the firm as “a legal fiction which serves as a focus for a complex process in which the conflicting objectives of individuals are brought into equilibrium within a framework of contractual relations.” See Jensen and Meckling, op cit n 30, at 311.

<sup>59</sup> D Millon, “Communitarianism in Corporate Law: Foundations and Law Reform Strategies”, in Lawrence Mitchell (ed), *Progressive Corporate Law* (Boulder, Colorado, 1995) p 3.

<sup>60</sup> R Posner, *Economic Analysis of Law*, (2nd ed, Little Brown, Boston, 1977), para 14.3. Cited in J Dine, op cit n 34, p 27.

### 1.2.1.3 Concession Theory

Concession theorists view the role of the State as facilitative in that it provides fair and democratic corporate governance structures. The creation and operation of the company is seen as a concession by the State. The ability to operate with limited liability is seen as an incentive for entrepreneurs to take on risky ventures without fear of personal liability.<sup>61</sup> These theories recognise that the company, as a creation of the State, owes duties to the public and ought to have a social conscience.<sup>62</sup> According to these theories, the interests of the company include, for instance, the interests of shareholders, employees, creditors because they all benefit the company.

### 1.2.1.4 Communitarian Theory.

Corporate law has a traditional commitment to the primacy of the shareholder. This entails a commitment on the part of the company and shareholders to maximise the welfare of shareholders.<sup>63</sup> As a result, the interests of shareholders are required to be considered in the event that they compete with any other interests. The shareholder primacy principle has been challenged by communitarians who recognise the interests of non-shareholder constituent groups. Communitarians regard a company as "an economic institution which has a social service as well as a profit-making function"<sup>64</sup> whose formation is encouraged by the law not only because they are a source of profit to their owners, but because they service the community.<sup>65</sup> For instance, parastatals were established in Kenya on this basis because they were thought to be the most appropriate mechanism for providing services that were not provided by the private sector.

Communitarian theorists are at odds with contractarian theorists because they do not agree that the sole purpose of the board is to use its powers for the maximisation of profits.<sup>66</sup> Instead, they regard the company as an entity having both a public role and

---

<sup>61</sup> *Re Rolus Properties Ltd & Another* (1988) 4 BCC 446.

<sup>62</sup> Campbell, "The Failure of the Market Failure", in *Corporate Control and Accountability* (McCahery, Picciotto, and Scot eds, Clarendon, Oxford, 1993) p 103.

<sup>63</sup> D Millon, op cit n 59, p 1.

<sup>64</sup> Dodd, "For Whom are Corporate Managers Trustees?" [1932] 7 *Harvard Law Review* 1145 at 1148.

<sup>65</sup> Ibid.

<sup>66</sup> According to Berle that is the sole purpose of the board. See Berle, "For Whom are Corporate Managers Trustees", (1932) 45 *Harvard Law Review* 1365; Dodd, op cit n 64.

a private one.<sup>67</sup> Whilst contractarian theorists argue against legal protection of non-shareholder constituencies, communitarian theories recognise the need to protect non-shareholders on the basis that disparities in bargaining power and lack of information prevent adequate protection of some non-shareholders through contracts. As such, bargaining power cannot be the sole basis for protecting non-shareholders because it is a function of wealth. As Professor David Millon observes:

"If shareholders' obligation is defined solely by reference to consent, nonshareholders' ability to protect themselves from the costs of shareholder wealth maximization will depend entirely on their ability to bargain and pay for necessary protection."<sup>68</sup>

Since communitarians see the corporation as "a community rather than a mere aggregation of self-seeking individuals whose relationships are defined solely by contract",<sup>69</sup> they argue that "additional legal structures must reinforce and supplement whatever gains people can achieve through contract."<sup>70</sup> For instance, communitarian proponents suggest that the board of directors should be empowered to consider shareholder and non-shareholder interests, such as employees and creditors because they contribute immensely to the success of the company.<sup>71</sup> The inequality of bargaining power between employer and employee has led to the enactment of statutes which safeguard health and safety of employees.<sup>72</sup> Although such legislation has recognised that companies owe to their employees the negative duties of not prejudicing their health and safety, there is a growing feeling that companies also owe their employers "the affirmative duty of providing them so far as possible with economic security."<sup>73</sup>

Whilst the application of this theory has the overall effect of promoting social welfare, it is doubtful whether the company, as a commercial tool, would continue to

---

<sup>67</sup> Stokes, "Company Law and Legal Theory" in *Legal Theory and Common Law* (W Twining, ed, 1986) pp 155, 162.

<sup>68</sup> D Millon, op cit n 59, p 7.

<sup>69</sup> Ibid p 4.

<sup>70</sup> Ibid p 11.

<sup>71</sup> Ibid p 13.

<sup>72</sup> Dodd, op cit n 64, at 1151.

exist if it were required to consider a very wide range on interests.<sup>74</sup> As Deakin and Hughes argue:

“If the category of stakeholding interests is widened to include those of all potential consumers of the company’s products, for example, or to refer to the general interest of society in the sustainability of the environment, there is a danger that the idea of stakeholding will cease to be relevant.”<sup>75</sup>

It is, therefore, necessary to strike a balance between the competing theories. This was done in the recent past by the UK’s Company Law Review Steering Group. The changes suggested in the review required directors to act in the interest of their members but subject to their constitution and taking account of all relevant considerations.<sup>76</sup> The study will, from time to time, evaluate the present law and suggested changes by applying the above-mentioned theories

### **1.2.2 Historical Framework**

#### **1.2.2.1 Kenya in the Pre-colonial Period**

Before the turn of the twentieth century, the economy of Kenya was almost entirely at a subsistence level. Money, as we know it today, did not exist and, therefore, any exchange of domestic production was done predominantly on a barter form of arrangement. Trade with the outside world was almost non-existent except for some Asian and Arab traders along the coast. The interest of the British government in East Africa at that time was limited to eradication of the slave trade.

The subsequent increase in European capitalism gave rise to the need in Europe for cheap raw materials, labour, and markets for products. This intensified European

---

<sup>73</sup> Ibid.

<sup>74</sup> Howard, “Corporate Law in the 80s: An Overview”, (1985) *Law Society of Canada Lecturers*. Cited in J Dine, op cit n 34, p 29.

<sup>75</sup> S Deakin and A Hughes (eds), *Enterprise and Community: New Directions in Corporate Governance*, (Blackwell, 1997) p 4.

<sup>76</sup> The recommendations rejected the “pluralist” or “stakeholder” view. See *Modern Company Law: Completing the Structure*, (DTI, London) para 3.2; *The Company Law Review Steering Group: Final Report* (DTI, London, 2001), p 41.

interest in Africa. The increasing European interest in Africa led to conflicts between European states over control of territories ("Scramble for Africa"). As a result, European states organised a conference, namely the Berlin Conference of 1885, to solve the conflicts. The conference gave rise to the Anglo-German Agreement of 1886, which formerly established Kenya as a British sphere of influence.<sup>77</sup> This marked the beginning of British control of the country through the Imperial British East Africa Company (IBEAC), which was incorporated in 1888. However, the failure of the company to control the territory gave rise to the direct involvement of the British government. As a result, the British government in 1895 declared the East African protectorate.

After becoming a British protectorate, the British government established the office of the Commissioner, which was meant to exercise executive, legislative, and judicial powers. By virtue of the East African Orders in Council of 1897 and 1899, the Commissioner had powers to administer the territory directly or appoint others to do so. He could make laws, establish judicial bodies, and maintain law and order. In 1905, the position of the Commissioner was replaced<sup>78</sup> with that of a Governor. Although the Governor was mandated to appoint all judicial officers, the 1905 Order in Council established the executive council (Exco) and the legislative council (Legco) to advise the Governor on general administration and pass laws respectively. Although membership to the Legco was only possible through nominations by the Crown, European settlers in 1919 were allowed to elect representatives. In contrast, Indians and Arabs did not have the right to elect representatives until 1924. On the other hand, the representation of Africans by others continued until 1944 when Africans were allowed to elect their own representatives.

Since the need for cheap raw materials, labour, and markets for products had intensified British interest in Kenya, Britain sought to acquire land for economic and administrative activities in order to settle farmers from outside the territory to engage in agricultural activities.

---

<sup>77</sup> Ibid p 12.

<sup>78</sup> By virtue of the 1905 Order in Council.

Since the British government could not legally justify<sup>79</sup> the acquisition of land, it extended in 1896 the Indian Land Acquisition Act 1894 in order to compulsorily acquire land for public purposes. Thereafter, the Land Regulations 1897 provided land to settlers but limited their occupancy to ninety-nine years, except in the Sultan of Zanzibar's dominions where settlers acquired freehold titles. To overcome the limitation, the East African (Lands) Order in Council 1901 was passed vesting all the land in the Crown thus making Kenyans "tenants at will". This was subsequently followed by the Crown Lands Ordinance 1915, which sped up the acquisition of land from Kenyans. It also sanctioned discriminatory policies of settlers, which kept non-whites out of the fertile highlands.<sup>80</sup> The discriminatory policies were clearly illustrated in the case of *Commissioner for Local Government, Lands, and Settlement v Kaderbhai*.<sup>81</sup> In that case, Kaderbhai, a British Indian subject of the Crown, applied to court for a writ of mandamus. He argued that the Commissioner of Lands<sup>82</sup> in selling town plots by auction<sup>83</sup> had no power to impose the conditions that Europeans only should bid or purchase; that the purchaser should not permit the dwelling-house or outbuildings which were to be erected to be used as a place of residence for any Asiatic or African who was not a domestic servant employed by him. The East African Court of Appeal allowed the appeal so far as it was claimed that Kaderbhai should be allowed to bid and purchase the plots in auction, but otherwise dismissed the right of occupancy claim.

#### 1.2.2.2 Reception of English Law

The desire to end the slave trade saw the British government enter into treaties with the Sultan of Zanzibar who controlled the East African coastal strip<sup>84</sup> and much of the slave trade. Given that the interpretation of the treaties was required, the agreements entered into were important in the development of the court system in East Africa. Enabling legislation was also enacted to give effect to the treaties. This factor led to the enactment of several statutes, which included the Slave Trade

<sup>79</sup> The Crown's Law officers had established in 1833 that a declaration of a protectorate did not entitle the Crown to alienate land in the Ionian Islands.

<sup>80</sup> *Commissioner for Local Government, Lands, and Settlement v Kaderbhai* [1931] AC 652 .

<sup>81</sup> [1931] AC 652.

<sup>82</sup> He was appointed under section 8 of the Crown Lands Ordinance 1915.

<sup>83</sup> They are provided for under sections 15 and 18 of the Crown Lands Ordinance 1915.

<sup>84</sup> The Sultan of Zanzibar had authority over an undefined portion of the East African coast and the interior. See Ghai & McAuslan, *Public Law and Political Change in Kenya* (Oxford University Press, 1970) p 3.

(Muscat) Act 1848. This Act was instrumental in introducing the Indian court system in East Africa. The expansion of the court system culminated in Zanzibar being declared a district of Bombay, where all the appeals lay. The jurisdiction of the East African courts was meant to be exercised in accordance with Indian legislation. As a result of the Indian influence on the legal system of East Africa, Indian administrative and legislative precedents became applicable in East Africa.<sup>85</sup>

The Indian precedents continued to apply in Kenya until the reception clause came into force thus obliging courts to apply English law. After the reception date, it was mandatory to apply English precedents even if the basic law governing a legal issue was an Indian Act. For instance, the Indian Contract Act was applied in Kenya until 1960 when it was repealed and replaced with the English common law of contract, which still applies today as the Law of Contract Act 1960.<sup>86</sup> The Government adopted this Act on the basis that it would have been difficult at that time to ascertain what the Indian law of contract was because the country had attained independence and, thus, was no longer bound by English law.<sup>87</sup> The Government ignored similar difficulties that Kenyans would encounter in establishing what the English law was. It also ignored the fact that Indian law, which grew from the Indian conditions, was more likely than English law to be relevant in Kenya.

The 1897 and 1905 East Africa Orders in Council gave the Commissioner power to establish courts and appoint judicial officers. The first judicial system applied more to Europeans than Africans and Asians. The system comprised subordinate courts, the High Court (later the Supreme Court) and the Judicial Committee of the Privy Council. The East African Court of Appeal (EACA) was created in 1902 and abolished in 1962, after the formation of East African Common Services Organisation in 1961. EACA was an instrument of the colonial regime and its judges were appointed by the Crown. The reliance on English law was intensified by decisions of the East African Court of Appeal and the Privy Council. The latter had

---

<sup>85</sup> Ibid p 128.

<sup>86</sup> Cap 23. Similarly, the English Occupiers Liability Act was enacted in Kenya in 1962 as Occupiers Liability Act No 21 of 1962, Cap 34. Similarly, the Limitation Act No 21 of 1968 was similar to English Limitation Act 1939. The Registered Land Act 1963 introduced concepts of English land law in Kenya.



an obligation to unify the common law throughout the British Empire.<sup>88</sup> Given the overwhelming influence of these courts, little was done to encourage the growth of Kenyan common law.

### **1.2.2.3 Colonial Period**

The declaration of the East African protectorate in 1895, marking out of boundaries, construction of the Uganda Railway, and increase in the number of white settlers, culminated in the declaration of Kenya as a British colony in 1920.<sup>89</sup>

Given that the driving force behind the coming to Kenya of white settlers was the creation of a colony that would offer opportunities for settlement, supply raw materials and a ready market for Britain, the settlement marked a major development in the Kenyan economy. For instance, the settlers introduced plantation agriculture, with the main crops being: coffee, tea, sisal, wheat and pyrethrum. They also introduced livestock ranching, money, and banking, which led to an increase in the trading and development of service and manufacturing industries.

The colonial government also established parastatals<sup>90</sup> on the understanding that they would provide the most appropriate mechanism for providing services that were not provided by the private sector. As public enterprises, they were also designed to curb the exploitation of consumers. As such, infrastructural services, such as ports, railways, airlines, post and telecommunication, were under the control of parastatals. Similarly, crop marketing boards were established to market the produce of settler farmers.

Since emphasis was on production of primary agricultural commodities, which were needed as raw materials for industries in Europe, the majority of the industries that developed were agricultural. To discourage competition with industries in Britain,

---

<sup>87</sup> The change followed British, rather than Kenyan, recommendations made by the British Institute of International and Comparative Law. The only legislation that did not follow English legislation was copyright law. See Ghai & McAuslan, op cit n 84, pp 377, 379.

<sup>88</sup> Ibid p 172.

<sup>89</sup> H Okoth-Ogendo, *Tenants of the Crown: Evolution of Agrarian Law and Institutions in Kenya*, (Nairobi, ATS Press, 1991) 10-17. Cited in K Kibwana, op cit n 15, p 14.

<sup>90</sup> See Chapter Six for a detailed analysis of parastatals.

the colonial government discouraged the development of any local industry, which threatened their home industries.<sup>91</sup>

Therefore, the economic development initiated by the colonial government, like infrastructural and human development, was intended to achieve the narrow objective of serving the colonial government and the settler community. For instance, any form of education given to the African community was intended to produce a low-level, unskilled labour force. This being the position, consequently the political and economic set-up during the colonial period did not have any interest in the local circumstances of Kenyans.

Although trading was a reserve for settlers, Africans started to get involved in trade towards the end of the colonial period, as they were eventually permitted to grow minimal cash crops. This was as a result of the increasing agitation in the 1950s within the Legco and labour movements for independence. This gave rise to constitutional conferences,<sup>92</sup> which eventually led to independence in 1963.<sup>93</sup> The conferences deliberated on the distribution of political power, property ownership, and economic development. The issues agreed upon in the conferences are still reflected in the present political and economic systems.<sup>94</sup> For instance, the British government and the settlers demanded in the 1962 Lancaster House Conference that the colony should receive independence under a constitution fashioned from the Westminster model.<sup>95</sup> The intention for retaining the Westminster model was to preserve the British common law system and in turn secure British interests in the country. As Ghai and McAuslan observe:

"Since the European had an overwhelming say in the direction of government policy,...Economic and political

---

<sup>91</sup> D Gachuki, *The Regulation of Foreign Investment in Kenya, 1963-81: An Empirical Study* (University of Warwick, PhD Thesis, 1982) p 21.

<sup>92</sup> The conferences were held in 1960, 1962, and 1963.

<sup>93</sup> Kenya was under British rule from 1897 to 1963. It became a republic in 1964.

<sup>94</sup> D Sifuna, "Nationalism and Decolonisation", cited in K Kibwana et al, op cit n 15, p 16.

<sup>95</sup> Changes subsequently took place and by 1970 Kenya did not have the Westminster model founded on "multipartyism, the central role of Parliament, the Executive's accountability to Parliament, and independence of the judiciary." The constitutional safeguards that existed were replaced between 1965 and 1970 with concentration of power in the Executive. See "Restructure the Office of the AG, Law Don Recommends" *Daily Nation*, 11 September, 2001; Wabwire, "Reflections on the Future of the Common Law in Kenya", *Law Africa* <[www.lawafrica.com/Articles](http://www.lawafrica.com/Articles)>

development was looked at from a European perspective and legislation was designed to further that development with little or no regard to the economic or social effects that such furtherance would have on Africans."<sup>96</sup>

#### **1.2.2.4 Post-Colonial Era**

During the negotiations for independence, a lot of attention was focussed on the political system, rather than the economic system, which the country was to inherit. However, a few economic issues, such as protection of property rights, were considered and enshrined in the Bill of Rights of the constitution enacted at independence.<sup>97</sup> It was agreed at the 1962 conference, which preceded the passing of constitution, that:

“The Bill of Rights would limit the public purposes for which land could be compulsorily acquired, and would also provide for payment of full compensation on acquisition, with right of access to the courts to determine the legality of the acquisition and the adequacy of the compensation.”<sup>98</sup>

The failure to deal adequately with the economic system that was suitable for the country led to the inheritance of “a basically capitalist socio-economic system, which the colonialists had been building for about seventy years or so.”<sup>99</sup>

One reason that can be attributed to the continuation of the colonial economic system was that African leaders thought that political liberalisation could change the economic system. As the former president of Tanzania, Julius Nyerere, observed:

"During our political struggle, some of us thought that independence would be the end of the process of liberalisation. We were now beginning to discover that political independence, alas, is not enough. You have to have

---

<sup>96</sup> YP Ghai and J McAuslan, op cit n 84, p 96.

<sup>97</sup> Section 75 of the present constitution.

<sup>98</sup> Report of the Kenya Constitutional Conference 1962 (London, HMSO, cmd 1700) at 10.

<sup>99</sup> K Kibwana et al, op cit n 15, p 21.

economic independence, and it is vital that the problems and areas of economic domination should be politically perceived before we can push the process of liberalisation to its logical conclusion. We perceived the problems of colonisation in its correct perspective. We saw colonisation as a wrong. That wrong was perceived politically by the leaders of the nationalist movements. Not all of us realised that we were also economically colonised. That wrong was not politically perceived. There was an underlying belief that political liberation would take care of economic independence too.<sup>100</sup>

In addition, the colonial government sought to continue their economic policies by enlisting the support of African leaders who in turn benefited from positions of power. Therefore, after independence the African elite stepped into the shoes of the colonial master and perpetuated the colonial policies. A clear illustration of this contention was seen when the British government sought to Africanise the white highlands to meet political objectives. Although the Kenyan government was given a large aid package to buy land from settlers, most of the fertile land was acquired by the elite regardless of the resultant indebtedness of the country.<sup>101</sup>

Despite the reluctance of the leaders to change, the government made the first attempt in 1965 to define the Kenyan socio-economic system in a policy document entitled "African Socialism and its Application to Planning in Kenya."<sup>102</sup> However, rather than defining African socialism, the document continued to affirm the economic system developed by the colonial government,<sup>103</sup> which emphasised, in the interests of finance capital, private ownership of the means of production, government intervention through limited public ownership and a wide range of government subsidies and control.<sup>104</sup>

---

<sup>100</sup> Nyerere 1979, cited in D Gachuki, op cit 91, p 2.

<sup>101</sup> Many of the loans advanced to the government had not been repaid by 1978. See Auditor General's Report 1978 in Gachuki DW, *ibid*, p 37.

<sup>102</sup> Sessional Paper No. 10 of 1965.

<sup>103</sup> Kibwana K et al, op cit n 15, p 16.

As Ghai and McAuslan observe:

"What has not occurred is an attempt to create a more African legal system for Kenya to blend together African legal system and English legal ideas and rules such as was sometimes rather half-heartedly attempted in the colonial period. The government seems to have decided that such attempts were still-born, and a modern unified legal system can only be built on the imported English base."<sup>105</sup>

Since the organisation of trade and commerce and the nature of commercial laws were not altered after the change of the political status of Kenya, the Kenyan laws, as Mutunga observes:

"Express the will of the international bourgeoisie first and foremost, the interests of the comprador bourgeoisie being championed because they primarily serve those of the former. Any interests derived by the Kenyan petty-bourgeoisie under this set of affairs are simply incidental and accidental too. Our political institutions, religious institutions, correspond to bourgeois views and ideology."<sup>106</sup>

When Kenya became independent, the suitability of other legal systems was not assessed. Therefore:

"The retention of the common law at independence was dictated by political expediency rather than the quality of the system itself. In fact there was no study of the merits of the common law, in comparison with alternative legal systems."<sup>107</sup>

---

<sup>104</sup> Ibid p 22.

<sup>105</sup> Ghai & McAuslan, op cit n 84, p 359.

<sup>106</sup> Mutunga, "Commercial Law and Development in Kenya", (1980) 8 IJSL 1 at 3.

Given that the reception of English law was not preceded by any planning, it can be argued that Kenya lost the chance of effecting measures that would have made the foreign law work. As Wabwile notes:

"Planned reception of foreign law allows for modification to be made to the content of the foreign law and prepares the receiving country to assimilate it. In the history of Kenyan private law these aspects of quantitative analysis and conscious synthesis of a legal system are lacking. It is a story of imposition of a legal system by a colonial master. Until now there has not been any critical assessment of the suitability of the common law legal system to this country and our legal destiny has been left to the dictate of fate."<sup>108</sup>

The heavy reliance on the English common law has not only been experienced in company law but in other fields as well. For instance, the Law of Contract Act<sup>109</sup> provides that the "common law of England relating to contract as modified by the doctrines of equity shall apply to Kenya."<sup>110</sup>

As opposed to the colonial times and the 1960s, the economy of Kenya today is characterised by a few salient factors, which include:

- High reliance on agriculture, especially agricultural export production.
- Government reliance on foreign capital for both investment and expenditure.
- High reliance on imported capital and consumer manufacturers.
- High population growth rate.
- High social stratification resulting in huge gaps between: the wealthy and the poor, urban and rural areas, and different regions of the country.

---

<sup>107</sup> Wabwile, op cit n 95.

<sup>108</sup> Ibid.

<sup>109</sup> Cap 23.

<sup>110</sup> Section 2 (1).

Given that the circumstances of Kenya have greatly changed, it remains arguable whether the law made in England during the "nineteenth century to satisfy the needs of capitalists operating in a laissez-faire environment, and later amended to cater for a highly sophisticated industrial society which increasingly emphasises big business, can be considered suitable to regulate the commercial organisations of'<sup>111</sup> Kenya. This being the position, Kenya can only rid itself of such drawbacks by nurturing its own common law.

### **1.3 Types of Companies**

There are five types of companies in the Kenyan legal system. These are:

- Companies limited by guarantee
- Unlimited companies
- Companies limited by shares
- Parastatals
- Foreign corporations, which are largely multinationals.<sup>112</sup>

#### **1.3.1 *Companies limited by guarantee***

Section 4 of the Act<sup>113</sup> allows the formation of a company limited by guarantee. In this type of company, the memorandum limits liability of its members to such amounts as the members may respectively undertake to contribute to the assets of the company in the event of being wound up.<sup>114</sup> Clubs, trade associations and societies formed to promote social objects usually fall under this category. These companies may operate with or without share capital.

#### **1.3.2 *Unlimited Companies***

By virtue of Section 4(2) (c) of the Act, a company not having any limit on the liability of its members may be formed. The characteristic of this type of companies implies that the members can be called upon to pay the full extent of their assets in order to meet the liabilities of a company.

---

<sup>111</sup> PA Thomas, op cit n 1, p viii.

<sup>112</sup> Foreign companies are required to be registered in Kenya by virtue of section 367 of the Act.

<sup>113</sup> Subsection (2) (b), Cap 486, The Laws of Kenya.

<sup>114</sup> Ibid.

Although an unlimited company need not have a share capital, it must have a memorandum of association which should state the amount of share capital, if any, and the number of members with which the company proposes to be registered. Whilst an unlimited company may be registered as limited, its rights or liabilities in respect of any debt or liability incurred, or any contract entered into before the registration are not affected.<sup>115</sup>

### **1.3.3. *Companies Limited by Shares***

These types of companies form the bulk of companies in Kenya and this thesis will, therefore, mainly deal with such companies. A company registered with limited liability may either be private or public. The Act requires a minimum of two members for the formation of a private company and seven members in case of a public one.<sup>116</sup> The constitution of a private company restricts the right to transfer its shares, limits the number of its members to fifty, and prohibits any invitation to the public to subscribe for its shares or debentures to the public for subscription.<sup>117</sup> On the other hand, a public company has no such restrictions. If a private company fails to comply with these restrictions, it loses its privileges and is treated as a public company. If, however, non-compliance was inadvertent or accidental a court may relieve the company from the consequences of non-compliance.<sup>118</sup> Most companies usually register first as private companies and then alter their constitutions to convert them to public companies before issuing prospectuses. This allows companies to avoid the requirements relating to commencement of the business<sup>119</sup> and having to hold statutory meetings before commencement of business.

### **1.3.4 *Parastatals***

These are corporations that are owned or primarily run by the state. They are either created by a special Act of Parliament or under the Act. Public corporations created by an Act of Parliament are operated within the objects set out in the Act creating

---

<sup>115</sup> Section 18.

<sup>116</sup> Section 4 (1).

<sup>117</sup> Section 30.

<sup>118</sup> Section 31.

<sup>119</sup> Section 111 of the Act restricts the commencement of business of a company with a share capital unless "every director of the company has paid to the company, on each of the shares taken or contracted to be taken by him and for which he is liable to pay in cash, a proportion equal to the proportion payable on application and allotment on the shares offered for public subscription."



them.<sup>120</sup> Most parastatals<sup>121</sup> are charged with the duty of carrying out special governmental functions in the national interest. The executive subjects these functions to some degree of control, while the corporation remains, to some extent, an independent entity. For instance, the State Corporations Act<sup>122</sup> vests the power of appointing a board of directors in the President<sup>123</sup> and the Minister.<sup>124</sup> The President is also empowered to "give directions of a general or specific nature to a board with regard to the better exercise and performance of the functions of the state corporation and the board shall give effect to those directions."<sup>125</sup>

Corporations created by an Act of Parliament have no shareholders to subscribe the capital. Borrowing, which is guaranteed by the Treasury, raises the capital necessary.<sup>126</sup> Although the property of the parastatals can be attached by its creditors, if it is unable to pay its debts, it cannot be wound up on the application of any creditor.

### **1.3.5 Multinational Corporations**

Multinational corporations contribute to foreign investment in Kenya by supplementing domestic savings and transferring technical know-how and business experience. Government policies designed to encourage foreign investment allow, among other protection measures: approved industries to repatriate earnings and capital; full and prompt compensation in the event of nationalisation; and industries receive an allowance for a return on capital invested in Kenya (investment allowance).<sup>127</sup>

While foreign investment may have some positive effects on the Kenyan economy, it is undoubtedly the case that heavy reliance on the same allows economic decisions affecting the economic future of the country to be dominated by foreign rather than

---

<sup>120</sup> In *Eastern Counties Rly v Hawkes* (1885) 5 HLC, 331, 348, Lord Cranworth observed that: "it must be now considered as a well settled doctrine that a company incorporated by Act of Parliament for a special purpose cannot devote any part of its funds to objects unauthorised by the terms of its incorporation, however desirable such application may appear to be."

<sup>121</sup> Examples of parastatals include: Kenya Tea Development Authority, Maize and produce board, Kenya Seed Company, Kenya Coffee Planters' Union etc.

<sup>122</sup> Cap 446, Laws of Kenya.

<sup>123</sup> Ibid s 6 (1) (a), the President appoints the chairman.

<sup>124</sup> Ibid s 6 (1) (e), the minister appoints the chief executive officer and other members of the board.

<sup>125</sup> Ibid s 7 (1)

<sup>126</sup> A Hussain, *A Textbook of Company Law in Kenya*, (EAEP, 1980) p 3.

domestic considerations. Being companies that are controlled and financed by foreign shareholders, profit motives of multinational corporations regulate their relationship with the Kenyan public. The same cannot be true of the shareholders of companies that are resident in Kenya. According to an empirical study conducted by Bornschieer and Stamm,<sup>127</sup> entry of multinational corporations in a market contributes to short term economic growth, but reduces long term growth performance. Although globalisation theorists consider multinationals to be rootless entities, they often "display strong ties to their countries of origin, and their primary focus is on national and regional markets in the developed world due to the existence of sophisticated markets, infrastructural features and political stability."<sup>128</sup>

The need to increase domestic participation in economic affairs is, to some extent, hampered by the presence of multinational corporations. Given that foreign investment does not make a direct contribution to the domestic ownership of assets, the government has in the past encouraged the Kenyanisation of the public sector. However, with the advent of globalisation, non-Kenyan ownership, management, and control of private enterprises has increased. In a bid to reduce some of the disadvantages linked to multinationals, the government requires foreign investors to tap domestic capital as part of their capital requirements, provide training facilities to Kenyans, and employ Kenyans where personnel with requisite skills and experience are available.<sup>129</sup>

#### 1.4 Conclusions

The regulatory framework of directors has affected adversely the standards of corporate governance in Kenya. This has, in turn, contributed to low investment in the economy and poor living standards for Kenyans. One of the reasons for this state of affairs is the fact that the regulatory framework of directors, having been inherited from the UK in 1962, has become seriously outdated. The current regulatory

---

<sup>127</sup> Hon T Mboya, op cit n 1, p 195.

<sup>128</sup> V Bornschieer and H Stam, "Transnational Corporations" in *The Law of the Business Enterprise* (S Wheeler, ed, OUP 1994), pp 333-334.

<sup>129</sup> L Pauly and S Reich, "National Structures and multinational corporate behaviour: enduring differences in the age of globalisation", [1997] *International Organisation*, 51:1, 1-30. Cited in Moran Jon, "Bribery and Corruption: the OECD Convention on Combating the Bribery of Foreign Public Officials in International Business Transactions", [1999] 8 (3) *Business Ethics: A European Review*, 141 at 143.

<sup>130</sup> The Immigration Act, 1967 (No 25 of 1967).

framework reflects the principles applicable in the UK in the colonial era and mirrors colonial policies in Kenya.

The compulsory acquisition of land from 1897 onwards by the colonial government marked the beginning of the use of political and economic power for improper purposes.<sup>131</sup> This resulted in the concentration of power during the colonial era on the institutions of the Commissioner and Governor, who were powerful and could hardly be questioned. Given that the Kenyan leaders who assumed positions of power at independence perpetuated the colonial policies, it appears that the colonial policies did influence the emergence of a highly centralised political system and a presidential institution, which remains unaccountable for appointing ineffective directors and failing to monitor the operation of parastatals.

Although the government encourages investment by enabling individuals to invest in risk taking enterprises through the medium of a limited liability company, it is not in doubt that the effectiveness of the limited liability company as a medium for wealth creation is rendered ineffective by the failure on the part of directors to act in the best interests of the company.

Apart from encouraging the creation of wealth, the government also enables the formation of companies, such as companies limited by guarantee and parastatals, to pursue social objectives. Whilst companies limited by guarantee may be established to promote certain social objectives, some parastatals have the responsibility of carrying out special governmental objectives in the national interest. Given that the government encourages the maximisation of wealth by limited liability companies and the performance of social functions by parastatals and companies limited by guarantee, it appears that the government adopts both the contractarian and communitarian theories in enabling the formation of companies. However, it is doubtful whether directors of limited liability companies are required to act in the

---

<sup>131</sup> The first anti-corruption laws were enacted during the colonial period. K Kibwana et al, op cit n 15, p 23.

interests of constituent groups, rather than the corporate entity, given that the law requires them to act bona fide in the best interests of the company.<sup>132</sup>

Since the circumstances of Kenya have greatly changed since independence there is a need to adopt a regulatory framework that is modern and effective. Effective reforms of the current regulatory framework would make it more relevant to the circumstances of Kenya and improve the performance of companies. This study seeks to examine how this might be done.

---

<sup>132</sup> *Trevor Price and Another v Raymond Kelsall* [1957] EA 752. This issue is discussed in more detail in Chapter Three.

## CHAPTER TWO

### 2.0 THE ROLE OF DIRECTORS

#### 2.1 Introduction

A registered company allows investors to profit from the company without managing it. Since a company, being an artificial person, cannot manage its own affairs,<sup>1</sup> human agents are endowed with the responsibility of management. These agents, referred to as “directors”, must manage the company efficiently to ensure that investors derive profit from the company. Poor management results in low returns, as a company can hardly attract new investors.<sup>2</sup> Apart from the losses that might be occasioned to investors and the company, failure of directors to exercise powers in the interests of the company<sup>3</sup> might lead to insolvency.<sup>4</sup> For instance, directors have contributed to the insolvency of companies in Kenya due to the commissioning of projects without competitive bidding, paying themselves excessive salaries, making excessive payments to external consultants, failing to undertake feasibility studies to determine the financial viability of investments, and sometimes using the entire board of directors, consciously or unconsciously, to rubber-stamp and ratify decisions.<sup>5</sup> As a result of such occurrences, the poor performance of a vast majority of companies and the economy of the country<sup>6</sup> is traceable to poor performance of the boards of companies.

---

<sup>1</sup> Cairns LJ in *Ferguson v Wilson* (1866) LR 2 Ch App 77, observed that “the company itself cannot act on its own person, for it has no person; it can only act through directors, and the case is, as regards those directors, merely the ordinary case of principal and agent.”

<sup>2</sup> Report of the Committee on the Financial Aspects of Corporate Governance (London: Gee 1992), para 1.6.

<sup>3</sup> *Percival v Wright* [1902] 2 Ch 421.

<sup>4</sup> The insolvency of Kenya National Assurance Company led to loss of millions of shillings by individuals and institutions that were insured by the company. See “Government Making Efforts to Save KNAC, says Okemo”, *East African Standard*, April 3, 2001.

<sup>5</sup> The Inspector of State Corporations attributed these factors to the insolvency status of the National Housing Corporation and recommended that the corporation should be put in liquidation. See “NHS Insolvent, Top Official Warns Government”, *East African Standard*, April 27, 2000.

<sup>6</sup> For a detailed analysis of how companies’ performance affect a country’s economy see BR Cheffins, *Company Law; Theory, Structure and Operation*, (Clarendon Press, 1997) p 606.

This chapter examines the role played by directors in a company and demonstrates why they need to be regulated. In addition, it addresses the procedural requirements for appointment of directors as well as the qualification criteria for appointment and the effect of having shadow, alternate, and assignee directors. The chapter goes on to highlight the legal nature and scope of the powers of directors.

## 2.2 Parastatals

Parastatals were established by the colonial government on the understanding that they would provide the most appropriate mechanism for providing services that were not provided by the private sector. Thus, most parastatals<sup>7</sup> are charged with the duty of carrying out special governmental functions in the national interest.

The position of directors in Kenya differs considerably from many other countries due to the presence of parastatals.<sup>8</sup> As opposed to a body corporate registered under the Companies Act (hereinafter referred to as the “Act”), parastatals do not have general meetings.<sup>9</sup> The government performs some of the functions of the general meetings by issuing directives or appointing members of the board of directors.<sup>10</sup> The outstanding organs of control in a parastatal organisation are the government and the parent Ministry. The State Corporations Act<sup>11</sup> vests the power of appointing boards of directors in the President<sup>12</sup> and the Minister.<sup>13</sup> The President is also empowered to:

“Give directions of a general or specific nature to a board with regard to the better exercise and performance of the functions of the state corporation and the board shall give effect to those directions.”<sup>14</sup>

---

<sup>7</sup> Examples of parastatals include: Kenya Tea Development Authority, Maize and Produce Board, Kenya Seed Company, Kenya Coffee Planters’ Union, Kenya Railways Corporation, National Housing Corporation, National Bank of Kenya, Kenya Commercial Bank, Kenya Power and Lighting, Agricultural Finance Corporation etc.

<sup>8</sup> Detailed analysis of parastatals is tackled in Chapter 6.

<sup>9</sup> Internal control of ordinary companies usually lies in the general meeting or in the board of directors as may be provided in the articles of association.

<sup>10</sup> James and Ligunya, “Organisational Relationship and the Control of Parastatals in Tanzania”, (1972) 5 *East African Law Review* 39 at 52.

<sup>11</sup> Cap 446, Laws of Kenya.

<sup>12</sup> S 6 (1) (a), the President appoints the chairman.

<sup>13</sup> S 6 (1) (e), the Minister appoints the chief executive officer and other members of the board.

<sup>14</sup> S 7 (1).

Being wholly appointees of either the President or the Minister,<sup>15</sup> board members often conform to the directions from the appointer. It is not uncommon, therefore, to find directives<sup>16</sup> demoralising the board and compromising their duty to act competently and in the best interests of the corporation.<sup>17</sup> Indeed, the sound financial performance of Mumias Sugar Company has been attributed to the management of the company's affairs by an independent agent, which has successfully resisted interference from the Government.<sup>18</sup>

## 2.3 Private Companies

### 2.3.1 *Appointment of Directors*

Directors are appointed through an ordinary resolution by shareholders in a general meeting. Whilst the Act provides for a minimum limit on the number of directors that a company must have,<sup>19</sup> it contains no provisions relating to the appointment of directors. The articles of the company therefore govern such appointments. Article 75 of Table A states:

"The number of directors and the names of the first directors shall be determined in writing by the subscribers of the memorandum of association or a majority of them and until such determination the signatories to the memorandum of association shall be the first directors."

Both the general meeting<sup>20</sup> and the board of directors<sup>21</sup> have the power to fill any casual vacancy arising out of death, resignation, retirement, or removal. Any

---

<sup>15</sup> The Ndegwa Committee cited poor selection process as one of the factors affecting performance of parastatals. Report and Recommendations of the (Philip Ndegwa) Committee on Review of Statutory Boards, Republic of Kenya, May 1979, para 1.8. p 3.

<sup>16</sup> The Government in 2000 issued a directive, which allowed 16 parastatal directors to continue serving despite attaining the mandatory retirement age for civil servants. See "Government Retaining 16 Parastatal Heads Aged over 55 Years", *East African Standard*, May 10, 2000.

<sup>17</sup> Section 3 of the State Corporation Act (Cap 446) empowers the President to appoint board members of parastatals. Under section 7, the President may also "give directions of a general or specific nature to a board."

<sup>18</sup> "Mumias Privatisation and the Bigger Picture", *Daily Nation*, September 30, 2001.

<sup>19</sup> Section 177 requires every company to have at least two directors, and at least one for private companies.

<sup>20</sup> Article 97, the company may make such appointment by ordinary resolution.

director so appointed is required to hold office only until the next following annual general meeting.

The Act requires every public company registered on or after 1<sup>st</sup> January 1962 in Kenya to have at least two directors, and every other company registered before the appointed day as well as every private company to have at least one director.<sup>22</sup> This requirement allows private companies to operate with one director when their functions are not entirely different from public companies. While the UK might have declined to implement the Jenkins Report's recommendation on having a minimum of two directors in its 1967 Companies Act, on the basis that the restrictions already in place made it difficult for a single director to act fraudulently,<sup>23</sup> having two directors still minimises the risk which exists where there is only one director because, as argued by Gower:

“If a single person could be sole member and sole director there would be little hope of preserving the separation of the company's property from that person's property or of safeguarding the assets of the company on the death of that person.”<sup>24</sup>

The UK's position has since changed and its Companies Act 1989 requires a minimum of two directors for a public company and one for a private company.<sup>25</sup>

### ***2.3.2 Restrictions on Appointment***

Although one is not required to have any qualifications to be appointed as a director,<sup>26</sup> the Act restricts certain persons from being appointed directors. These include, for public companies having share capital:

---

<sup>21</sup> Article 95.

<sup>22</sup> Section 177.

<sup>23</sup> J Katende, “Company Law in East Africa: Present and future, with particular reference to Tanzania Mainland”, (1969) 2 *East Africa Law Review* 149.

<sup>24</sup> Final Report of the Commission of Enquiry into the Working and Administration of the Present Company law in Ghana, 1961, p 129 (Drafted by Professor Gower).

<sup>25</sup> Section 282.

<sup>26</sup> In *Marquis of Bute's Case* [1892] 2 Ch 100 an infant was appointed as a director.



- Anyone who has not complied with conditions laid down in Section 182 (1) regarding consenting in writing to act as such director.
- Anyone who does not hold a specified share<sup>27</sup> qualification.<sup>28</sup>
- Anyone who has not attained the age of twenty-one or has attained the age of seventy.<sup>29</sup>
- Anyone who is an undischarged bankrupt.<sup>30</sup>
- And anyone convicted of any offence in connection with the promotion, formation or management of a company.<sup>31</sup>

It is worth noting that although the Act imposes an age limit on directors, it is still possible to exclude the effect of the age limit by having the appointment approved by the general meeting. It is also possible for a person above the age limit to serve as a director where the articles expressly permit it.<sup>32</sup> Moreover, if a director were ineffective by reason of age, it would still be possible to remove him through a special resolution under Section 185 of the Act.

Although the Act disqualifies<sup>33</sup> some people<sup>34</sup> from being appointed as directors, companies in Kenya continue to be run by incompetent, negligent, and fraudulent directors. A survey conducted between October 2001 and January 2002 in Nairobi indicated that the disqualification regime in Kenya is ineffective.<sup>35</sup> Eighty-nine percent of the respondents felt that there is little chance of directors being sued for breach of duties when companies enter liquidation. Ninety-two per cent of the respondents took the view that disqualification orders are extremely rare.

---

<sup>27</sup> It is considered likely for directors without a stake in the company to manage a company less efficiently. See Mayson et al, *Company Law*, (Seventeenth edition, Blackstone Press, 2000) p 437

<sup>28</sup> Section 183.

<sup>29</sup> Section 186. This provision does not apply if the company's articles provide otherwise or where special notice of the resolution to appoint the director was given to the company.

<sup>30</sup> Section 188 makes it a criminal offence to so act.

<sup>31</sup> Section 189.

<sup>32</sup> Private companies are not subject to the age limit. See Section 186 (5).

<sup>33</sup> Disqualification of directors is considered in detail in Chapter 8.

<sup>34</sup> Directors must be natural persons, minors may not be appointed as directors, and directors should also have share qualifications. See sections 183 (1) and 186 of the Act.

<sup>35</sup> The results of the survey are discussed in detail in Chapter Nine.

The failure to prevent such persons from being appointed has made it possible for people who have contributed to the insolvency of companies<sup>36</sup> not only to be appointed to other directorships,<sup>37</sup> but also to serve as Government Ministers and Assistant Ministers.<sup>38</sup> For instance, in spite of some 45 parastatals and companies in which the Government has shares being placed in receivership since 1980 some directors who were responsible for the collapse of such companies have not only been appointed to other positions of directorships but they have also been appointed to the Cabinet. For example, despite the allegations levelled against the former managing directors of the defunct Kenya National Assurance and Kenya Posts and Telecommunications Corporations, Henry Kosgey and Kipng'eno arap Ng'eny respectively, the two were appointed to direct other companies and subsequently appointed to the Cabinet.

The Act does not provide any criteria for share qualification of directors. It leaves the qualification to be fixed by the company in general meeting.<sup>39</sup> This not only prevents directors from using their votes to influence the decision of the general meeting, but also makes it possible for directors who are unwilling or incapable of investing in a company, to work for it. It may be argued, however, that such directors are not better placed to safeguard the interests of the company, since they have no stake in it. Although it is true to say that directors with a stake in a company tend to be more efficient, as their rewards are tied to the prosperity of the company,<sup>40</sup> it is also the case that a sizeable stake would enable them to influence voting in general meetings.<sup>41</sup>

---

<sup>36</sup> "45 Parastatals, Govt Firms in Receivership", *East African Standard*, July 12, 2001.

<sup>37</sup> "The tragedy in Kenya is that those who have mismanaged the Government, the Development Finance Institutions, and even multinational corporations are those who continue to circulate in and out of Government as ministers, assistant ministers, advisers and so on." See Nyong'o, "How Bad Governance Strangles Business", *Daily Nation*, June 10, 2001.

<sup>38</sup> "How Bad Governance Strangles Business", *Daily Nation*, June 10, 2001.

<sup>39</sup> Article 77, Table A. Companies that do not adopt Table A of the Act can impose conditions of share qualification. If this is done, the conditions must be fulfilled.

<sup>40</sup> Riley, "The Company Director's Duty of Care and Skill: The Case for an Onerous but Subjective Standard", (1999) 62 MLR 697 at 704.

<sup>41</sup> In *Bushell v Faith* [1970] AC 1099, the Court of Appeal held that since section 184 of the Companies Act, 1948, did not prevent certain shares from having special voting rights attached to them on certain occasions, it did not invalidate an article giving the shares of a director loaded voting rights.

### **2.3.3 Types of Directors**

The Act defines a director as "any person occupying the position of a director, by whatever name called".<sup>42</sup> Although this definition ensures that a person who is not appointed as a director, but who acts as a director, does not escape liability, it casts some doubts as to where the actual powers of company management lies, as any officer in the company to whom powers have been delegated might be referred to as a director. As such, the definition includes in its ambit persons who are not duly appointed by the company as directors, as it operates to include any person whose work, duties, and obligations to the shareholders are similar to those of a director.

#### **2.3.3.1 Alternate Directors**

Section 139 of the Act allows a company to authorise a person to act as its representative at any meeting of the company or at any meeting of any class of members of the company. The representative is usually referred to as the "alternate director." The alternate director may be another member of the board or a different person. His appointment must be approved by a resolution of directors. Although an alternate director acts on behalf of the appointing director, he is not an agent of the appointor. As such, he is responsible for his own acts and is not bound to vote according to the instructions of the appointor. His appointment ceases when the appointor vacates office.<sup>43</sup>

Although having alternate directors may be deemed inappropriate on the basis that some alternate directors may not normally qualify to be directors under usual circumstances, it is not in doubt that they can play a crucial role in the management of the company, as they serve as deputies of directors in their absence and get the experience of running companies.

Section 139 permits a corporation, if it is a member of another corporation, to "authorise such person as it thinks fit to act as its representative at any meeting of the company." Given that this provision allows various persons to represent the corporation in various occasions, it might be difficult to attach liability to any one person. As a result, it is desirable for a corporation to appoint a permanent

---

<sup>42</sup> Section 2 (1) being a director is categorised as "holding office rather than being an employee." See *McMillan v Guest* [1942] AC 561.

representative, duly approved by the general meeting, on the board so as to cure the defects of multiple representation of a corporation, a problem envisaged by the Jenkins Report.<sup>44</sup>

### **2.3.3.2 Company Chairman**

A company chairman is endowed with the responsibility of supervising and presiding over board meetings. In the event that votes become tied in a board meeting, the chairman has the right to a casting or second vote.<sup>45</sup>

### **2.3.3.3 De Facto Directors**

Instead of being appointed to a directorship, a de facto director performs duties, which are usually performed by a director. A person may therefore be regarded as a de facto director where:

“Clear evidence that he had been either the sole person directing the affairs of the company (or acting with others all equally lacking in a valid appointment) or, if there were others who were true directors, that he was acting on an equal footing with the others in directing the affairs of the company.”<sup>46</sup>

Tasks performed by a manager below board level are not sufficient to make one a de facto director, as the functions in question must relate to tasks ordinarily performed by a director.<sup>47</sup>

A de facto director is treated as an ordinary director for all purposes. This was illustrated in the case of *R v Ivan Arthur Camps*<sup>48</sup> where the respondent was charged with several offences, including failure to acquire necessary share qualification, under the Act. The East African Court of Appeal considered whether the respondent

---

<sup>43</sup> Article 6, Table A of the Act.

<sup>44</sup> Report of the Company Law Committee, Cmnd 1749, Para 99 (1962).

<sup>45</sup> Article 60, Table A.

<sup>46</sup> *Re Richborough Furniture* [1996] 1 BCLC 507 at 524, per Timothy Lloyd QC.

<sup>47</sup> *Re Hydrodam (Corby) Ltd* [1994] 2 BCLC 183; *Re Kaytech International Plc Portier v Secretary of State for Trade and Industry* [1999] BCC 390.

<sup>48</sup> [1962] EA 403.

could be regarded as a director given that he had not acquired the qualifying shares. The Court held that:

“(i) The word director in the Companies Ordinance includes a de facto director unless the context otherwise requires, and looking at the mischiefs at which the sections in question is aimed a de facto director is as much a person whose conduct should be the subject of the sections as a person who has been duly appointed as a director.

(ii) The respondent was validly and duly appointed a de jure director but he ceased to be a de jure director two months later as he failed to acquire his share qualification within that time.

(iii) If the respondent acted as a director after the expiration of two months from his appointment he was then a de facto director and he was a director for the purposes of those sections of the Companies Ordinance which it was alleged he contravened.”<sup>49</sup>

#### **2.3.3.4 Managing Director**

Article 107 of Table A provides that "the directors may delegate any of their powers to committees consisting of such member or members of their body as they think fit; any committee so formed shall in the exercise of the powers so delegated conform to any regulation that may be imposed on it by the directors." This article empowers the board of directors to appoint one director, the managing director, to run the daily affairs of the company.

#### **2.3.3.5 Non-Executive and Executive Directors**

A non-executive director is a person who is involved in the management of a company, but who does not devote his whole working time to the company. Due to this consideration, a non-executive director receives less remuneration than an executive director. He receives remuneration at the discretion of the general meeting and the company's articles determine the length of his term of office.

Ideally, non-executive directors play a supervisory role on the board. Since they are usually experienced individuals, they are able to ensure that a board of a company acts in the interests of a company rather than that of the board members.<sup>50</sup> Sometimes, their role can become ineffective if a powerful managing director overshadows them.<sup>51</sup> It is for this reason that the UK's Principles of Good Governance and Code of Best Practice ("Combined Code") provides that:

“The board should include a balance of executive and non-executive directors (including independent non-executives) such that no individual or small group of individuals can dominate the board’s decision taking.”<sup>52</sup>

Given that non-executive directors may be liable for breach of their duties to the company, they have the responsibility of keeping abreast of the activities of the board.

In contrast, an executive director devotes all his time discharging specific functions to the company and, in turn, receives more remuneration.<sup>53</sup> The appointment and the setting out of the terms of service of an executive director are the responsibilities of the board of directors.

#### **2.3.3.6 Nominee Directors**

A majority shareholder in a private company can appoint one or more directors to represent him on the board.<sup>54</sup> Such a director is referred to as a “nominee director.” A nominee director must act *bona fide* and in the best interests of the company. In addition:

"He may take into account and act on the wishes of his appointor provided he exercises a real discretion and that, in so doing, the nominee director honestly and reasonably

---

<sup>49</sup> [1962] EA 403 at 404.

<sup>50</sup> BR Cheffins, n 6, p 604.

<sup>51</sup> *Re Polly Peck International Plc (No 2)* [1994] 1 BCLC 574.

<sup>52</sup> Principle A.3.

<sup>53</sup> S Griffin, *Company Law: Fundamental Principles* (Third edition, Longman, 2000) p 227.

<sup>54</sup> Mayson et al, *Company Law*, (Seventeenth edition, Blackstone Press, 2000) p 449.

believes he is acting bona fide and in the best interests of the company."<sup>55</sup>

The fact that nominee directors are required to disregard the interests of their appointers, in favour of the shareholders as a whole, may result in them coming into a collision course with appointors.

Therefore, requiring a nominee director to act only in the interests of the company is an impossible feat to achieve because he can hardly ignore the instructions and interests of the appointor.<sup>56</sup>

### **2.3.3.7 Shadow Directors**

Section 201(9) (a)<sup>57</sup> recognises, as directors, persons with whose directions or instructions<sup>58</sup> the directors of a company are accustomed to act. This presupposes that shareholders at a general meeting do not necessarily appoint directors. A company must, therefore, have directors whether it appoints them or not, because those who manage its business will be occupying the position of directors and so regarded as directors by the law.<sup>59</sup> These persons are referred to as "shadow directors".<sup>60</sup> Shadow directors<sup>61</sup> differ from de facto directors in that shadow directors are not held out as directors. Also, the degree of control over company's affairs required for a person to be regarded a shadow director is more than that required for a de facto director.<sup>62</sup> Shadow directors can be held liable for breach of their duties as directors.<sup>63</sup>

---

<sup>55</sup> Crutchfield, "Nominee Directors: The Law and Commercial Reality", (1991) 12 Co Law, 136.

<sup>56</sup> Ibid at 137.

<sup>57</sup> The Act. UK's Companies Act 1985 also recognises shadow directors under section 741 (2).

<sup>58</sup> Advice given in a professional capacity does not make the adviser a shadow director. See Mayson et al, *Company Law*, (Seventeenth edition, Blackstone Press, 2000) p 437.

<sup>59</sup> Section 2 (1) defines a director as "any person occupying the position of a director, by whatever name called."

<sup>60</sup> A shadow director is different from a de jure and a de facto director. For a distinction see *Re Hydromam (Corby) Ltd* [1994] 2 BCLC 180. Also see the discussion in Griffin, "The Characteristic and Identification of a De Facto Director", [2000] *Company Financial and Insolvency Law Review* 126.

<sup>61</sup> The UK legislation recognises shadow directors, albeit taking a different approach by distinguishing them from other directors by using the term "shadow director." See s 741 (1) UK Companies Act 1985.

<sup>62</sup> S Griffin, op cit n 53, p 231.

<sup>63</sup> *Selangor United Rubber Estates Ltd v Cradock (No 3)* [1968] 1 WLR 1555.

It is important for all directors to be accustomed to act regularly<sup>64</sup> in accordance with the instructions of a person for that person to be termed a shadow director.<sup>65</sup> Thus, the following conditions needs to be met for a person to be called a shadow director:

"It is not necessary to show that the person gives directions or instructions on every matter on which the directors act, but it must be shown that the person has a real influence<sup>66</sup> in the company's corporate affairs; whether any particular communication should be classed as a direction or instruction is for the court to determine objectively; advice (provided it is not professional advice) may be a direction or instruction; it is not necessary to show that the directors adopted a subservient role or surrendered their discretion; despite the use of the term "shadow director" it is not necessary to characterise the person as 'lurking in the shadows'. It is possible for a person to be a shadow director quite openly."<sup>67</sup>

Due to the difficulty that might be encountered while determining whether a person is a director, it would be more appropriate to define directors specifically as persons appointed by the company or those held out by the company as directors and make provision for their appointment by the general meeting to avoid the possibility of shareholders being misled by the wide definition.<sup>68</sup>

## **2.4 Powers of Management**

### **2.4.1 Division of Powers Between Members and Directors**

It is incumbent upon directors, as agents for the company, to perform their duties collectively as a board and not individually. The central role played by directors in

---

<sup>64</sup> *Re Unisoft Group Ltd (No 3)* [1994] 1 BCLC 609 at 620.

<sup>65</sup> *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd* [1991] 1 AC 187 at 223.

<sup>66</sup> Deciding which cheques drawn by the company would not be submitted to the bank was sufficient interest to render an accountant a shadow director in *Re Tasbian Ltd (No 3)* [1992] BCC 358.

<sup>67</sup> *Secretary of State for Trade and Industry v Deverell* [2000] 2 WLR 907 (CA).



steering a company calls for the highest performance and competence. Failure by a director to act diligently may warrant either removal by the shareholders or the initiation of a court action for any fraud or breach of duty.

The company vests some of its management powers in the directors,<sup>69</sup> subject to the articles of the company, while others are reserved to the general meeting.<sup>70</sup> The board of directors is the body that has the power to make decisions and determine the delegation of powers. The board transacts business through board meetings that are regulated by the articles of a company. Given that the board is able to delegate its powers to one or more directors,<sup>71</sup> it is able to carry out its regular functions without having to pass resolutions.

Being independent from shareholders, directors are not servants to obey directions given by shareholders as individuals, because they have the ability to exercise the powers that are vested in them by the articles.<sup>72</sup>

The power of the board to manage the company was upheld by the East African Court of Appeal in *Peter G Ellis v NG Bailey & Co (East Africa) Ltd*<sup>73</sup> where the appellant challenged the termination of his directorship by other directors. The ground upon which the director challenged the termination was that the resolution by directors had not been passed in a general meeting, as required by clause 68 of Table A of the Act. Finding that the directors had power to dismiss the appellant, the Court held that the power of management of directors was not affected by the power of the general meeting to determine the appointment of the appellant in general meeting. Newbold JA observed:

---

<sup>68</sup> Nigeria Law Reform Commission, *Working Papers on the Reform of Nigerian Company Law: Volume 1-Review and Recommendations*, 1987, pp 174.

<sup>69</sup> Table A, arts 102, 107-109 provide for the delegation by the board of their powers to committees of one or more or to a managing director.

<sup>70</sup> Table A, Article 80 of the Companies Act Cap 486 provides that "the business of the company shall be managed by the directors, who may pay all expenses incurred in promoting and registering the company, and may exercise all such powers of the company as are not, by the Act or by these regulations, required to be exercised by the company in general meeting..."

<sup>71</sup> Table A, article 72.

<sup>72</sup> "I cannot see anything in principle to justify the contention that the directors are bound to comply with the votes of resolutions of a simple majority of an ordinary meeting of shareholders. It is not true to say that directors are mere agents. Directors are managing partners." See *Automatic Self-cleansing Filter Syndicate Co Ltd v Cunningham* [1906] 2 Ch 34 per Cozen-Hardy LJ at 44.

<sup>73</sup> [1962] EA 26.

“Table A gives to the directors a power to appoint a managing director on such terms as may be agreed. Such terms could include a provision that the managing director was to continue as such for a specified period or a provision that he was not to be dismissed without reasonable notice...there remains the overriding power of the company in general meeting to terminate the appointment. But, subject to the dismissal not being contrary to any terms, express or implied, of the appointment, the directors by having the power to appoint, inherently also have the power to dismiss.”<sup>74</sup>

Shareholders can only control the exercise of powers vested in the directors<sup>75</sup> by altering the articles.<sup>76</sup> A shareholder may, nevertheless, enforce the articles against the directors by means of the general contractual right to compel the company to conduct its affairs in accordance with the Articles.<sup>77</sup> The division of powers between shareholders and directors clearly separates ownership of companies from their control. However, although directors are independent from shareholders, they remain fiduciaries of the company. As such, the courts can control their powers to ensure that they act in the interests of the company.

There are two opposing views regarding whether Article 80 of Table A<sup>78</sup> vests exclusive management competence in the directors.<sup>79</sup> Article 80, which explains the power to manage a company states:

---

<sup>74</sup> Ibid at 30.

<sup>75</sup> The Articles of association provide for the regulation of the internal administration of the company.

<sup>76</sup> Section 13 of the Companies Act gives powers to the Company to alter or add to its Articles by passing a special resolution. It states that 'any alteration made in the Articles shall, subject to the provisions of the Act, be as valid as if originally contained therein.'

<sup>77</sup> Wedderburn, "Shareholders' Rights and the Rule in *Foss v Harbottle*", [1957] CLJ 194, 212.

<sup>78</sup> Table A is part of the Act.

<sup>79</sup> The two views are discussed by Hornby, "The Relationship Between the Board of Directors and the General Meeting in Limited Companies", (1977) 93 LQR 569; A Berle and G Means, *The Modern Corporation and Private Property*, (New York: The Macmillan Company, 1932) [Reprint, Transaction Publishers, New Brunswick, N J, 1991].

"The business of the company shall be managed by the directors who may... exercise all such powers as are not by the Act or by these regulations, required to be exercised by the company in general meeting, subject nevertheless, to any of these regulations, to the provisions of the Act and to such regulations being not inconsistent with the aforesaid regulations or provisions as may be prescribed by the company in general meeting."

The minority view relating to the interpretation of this Article recognises that directors have the authority to manage a company subject to the constraints of the articles,<sup>80</sup> the provisions of the Act, and regulations prescribed by the company in general meeting.<sup>81</sup>

On the other hand, members are seen, under the majority view,<sup>82</sup> to have no authority to give directions on how the company affairs are managed.<sup>83</sup> They cannot also overrule any decision arrived at by the directors in the conduct of its business.<sup>84</sup> While it is the case that shareholders in general meeting can give controlling directions to the board in matters of management by passing ordinary resolutions,<sup>85</sup> such intervention is "subject to the proviso that the management function must reside in the directors."<sup>86</sup> Any shareholder intervention<sup>87</sup> that is too frequent to

---

<sup>80</sup> *Marshall's Valve Gear Co Ltd v Manning, Wardle & Co Ltd* [1909] 1 Ch 267, 274.

<sup>81</sup> For a detailed comment on the need for directors to be controlled by members see, Sullivan, "The Relationship Between the Board of Directors and the General Meeting in Limited Companies", (1977) 93 LQR 569.

<sup>82</sup> PL Davies, *Gower's Principles of Modern Company Law*, (Sixth Edition, Sweet & Maxwell, 1997) p 632.

<sup>83</sup> The power derived from Table A, article 70 that permits directors to litigate in the name of registered company cannot be controlled by members. See *John Shaw and Sons (Salford) v Shaw* [1935] 2 KB 113.

<sup>84</sup> *Dowse v Marks* (1913) SR (NSW) 332.

<sup>85</sup> If the shareholders pass a resolution directing the board to invest in one manner rather than another, the board must manage the company in such a manner as gives effect to the resolution. Traditionally, shareholders could not remove directors in the UK unless those articles provided for powers to dismiss. (*Imperial Hydropathic Hotel Co; Blackpool v Hampson* (1882) 23 Ch D 1). However, this position has since changed and members of a company can dismiss company directors by passing ordinary resolutions. See Table A of the Companies Act 1985, article 70 and section 303 Companies Act 1985.

<sup>86</sup> Hornby, "The Relationship Between the Board of Directors and the General Meeting in Limited Companies", (1977) 93 LQR 569 at 578.

exclude discretion in the implementation of policy will, therefore, be unjustified. While it may seem that the ultimate authority of the company is the board of directors, it remains true that such authority lies in the constitution of the company. Therefore, although the members may regard the company as "their company" because they own it, they cannot override the powers that the directors have been given by them in Articles. Unless members change the articles by special resolution or change the directors by ordinary resolution, they must yield to the authority of directors.<sup>88</sup> Moreover, a general meeting is incapable of retrospectively reversing or annulling the boards acts or decisions.<sup>89</sup>

The management powers vested in the general meeting include: election of directors, remuneration of directors, declaration of dividends, and removal of directors from office.

## **2.5 Relationship with the company**

### **2.5.1 Are Directors Trustees or Agents?**

The constitution of a company, which has contractual effect as between the members and the company, govern the rights and obligations of directors.<sup>90</sup>

The Act does not indicate the precise relationship that the directors bear to the company, but common law and equity principles provide some guidelines. Common law deems directors as "commercial men managing a trading concern for the benefit of themselves and of all the shareholders in it. They stand in a fiduciary position towards the company in respect of their powers and capital under their control."<sup>91</sup>

---

<sup>87</sup> Ibid at 579. Hornby observes that the right of intervention under Article 80 is largely theoretical because the shareholders are usually too numerous to act effectively as a body, and have largely acquiesced in effective control by the board of directors.

<sup>88</sup> In *Scott v Scott* [1943] 1 All ER 582 it was held that a unanimous resolution by all the members to declare a certain dividend was of no effect unless the directors approved it.

<sup>89</sup> Loose et al, *The Company Director*, Seventh Edition (Jordans, 1993) p 97.

<sup>90</sup> Section 22 of the Companies Act Cap 486 state that "the memorandum and articles, when registered, bind the company and its members to the same extent as if they had been signed and sealed by each member and as if they contained covenants on the part of each member to observe all their provisions."

<sup>91</sup> *Re Forest of Dean Coal Mining Company* (1878) 10 Ch D 450 per Jessel MR at 452.

In some key respects, the general principles of principal and agent regulate the relationship of the company and its directors,<sup>92</sup> as directors are deemed to be agents of the company. For instance, in relation to contracts entered into by a director, it is normally the company and not the director who is liable.<sup>93</sup> If he exceeds his authority he may be liable to a third party for breach of warranty of authority.<sup>94</sup> Similarly, like other agents he must account to his principal for any personal profit made by him out of his position.<sup>95</sup> Despite these similarities with an agent, a director, however, differs from other agents in that he is in control of the affairs of his own principal.

Although they have been seen, traditionally, as agents of the company, in respect of the transactions entered into on behalf of the company,<sup>96</sup> some modern writers do not agree with this classification. Gower observes:

"The directors have ceased to be mere agents of the company. Both they and members in general meeting are primary organs of the company between whom the company powers are divided."<sup>97</sup>

Since directors also manage the affairs of the company for the benefit of the shareholders, they are sometimes referred to as trustees.<sup>98</sup> For instance, they can be regarded as mere trustees,<sup>99</sup> in respect of the money and property they are entrusted with, the exercise of all powers which they are authorised to exercise on the company's behalf, such as allotting shares, entering into contracts, making calls etc. As such, directors who occasion losses to a company by acting beyond the authority

---

<sup>92</sup> *Ferguson v Wilson* (1866) LR 2 Ch App 77.

<sup>93</sup> *Briess v Wolley* [1954] AC 333; *Elkington & Co v Hurter* [1892] 2 Ch 452.

<sup>94</sup> *Firbank's Exors v Humphreys* [1886] 18 QBD 54.

<sup>95</sup> In *Allen v Hyatt* (1914) 30 TLR 444, directors were held liable to members for making undisclosed profit from the sale of members' shares. Also see *Industrial Development Consultants Ltd v Cooley* [1972] 2 All ER 86.

<sup>96</sup> *GE Railway v Turner* (1872) LR 8 Ch App 149.

<sup>97</sup> PL Davies, op cit n 82, p 632.

<sup>98</sup> Romilly MR in *York and North Midland Rly V Hudson* (1853) 16 Beav 485 saw it as an office of trust which, if they undertake, it is their duty to perform fully and entirely.

<sup>99</sup> In law, trustees are persons in whom the legal ownership of assets is vested, which they must administer for the benefit of the beneficiaries who can enforce their interests by suing the trustees. See A Hussain, *Company Law in Kenya*, (East African Educational Publishers, 1993), p 104.

conferred upon them are accountable for the misapplication on ordinary trust principles.

Directors could therefore be rightly described as trustees on the basis that any assets in their hands are held on trust for the company,<sup>100</sup> their powers must be exercised for the benefit of the company,<sup>101</sup> and that they are in a fiduciary position and their personal interests must not conflict with their duties to the company.<sup>102</sup> However, directors differ from trustees because the trust property is not vested in them, their duties of management involve taking risks as opposed to those of a trustee, and their duties of skill and care are lower than those of ordinary trustees.<sup>103</sup> In addition, a trustee, unlike a director, can only resign from the trust when he has carried out his duties to the courts' satisfaction. On the other hand, the role of a director, such as initiating the venture of a company, is almost wholly discretionary.<sup>104</sup>

Despite the difficulty in classifying directors, it is not in doubt that directors exercise their duties for a corporate body, which implies a relationship akin to an agency-principal relationship. Given that shareholders entrust them with the management of the enterprise, monies, and property,<sup>105</sup> their relationship with directors resembles that of beneficiaries and trustees. This was clearly summed up by Romer J in *Re City Equitable Fire Insurance Co Ltd*:

"It has sometimes been said that directors are trustees. If this means no more than that directors in the performance of their duties stand in a fiduciary relationship to the company, the statement is true enough. But if the statement is meant to be an indication by way of analogy of what those duties are it appears to me to be wholly misleading."<sup>106</sup>

---

<sup>100</sup> *Selangor United Rubber Estates Ltd v Cradock (No 3)* [1969] 2 All ER 1073.

<sup>101</sup> In *Piercy v S Mills & Co Ltd* [1920] 1 Ch 77, it was held that directors must not issue shares for the purposes of maintaining their control.

<sup>102</sup> *Scottish CWS Ltd v Meyer* [1958] 3 All ER 66.

<sup>103</sup> Loose et al, *The Company Director*, Seventh Edition (Jordans, 1993) p 32.

<sup>104</sup> Sealy, "The Director as Trustee", [1967] CLJ 83 at 89.

<sup>105</sup> In *GE Ry v Turner* (1872) LR 8 Ch App 149, Lord Selbourne held that directors are mere trustees or agents of the company, that is, trustees of the company monies and property, and agents in the transactions which they enter into on behalf of the company.

<sup>106</sup> (1925) Ch 407, 426.

Although they are not trustees in a strict sense it is clear that directors stand in a fiduciary relationship, as trustees of money, which come into, their hands or which is under their control. Therefore, they must exercise their powers not in their own interest, but honestly in the interests of the company.<sup>107</sup> A fiduciary relationship is imposed upon them and this means that directors owe duties of loyalty and good faith, similar to those imposed upon a trustee. As agents, directors are under an obligation to exercise due diligence and skill in exercise of their powers.<sup>108</sup> The exact ambit of these powers has to be derived from a mass of judge-made law, which is not clear.

### **2.5.2 Power to bind the company**

Any contractual transaction entered into by directors which goes beyond the constitution of a company is treated as ultra vires,<sup>109</sup> and therefore void. Directors in Kenya are able to bind their company if they act within their powers and within the constitution. A person involved in a transaction with a company is deemed to have constructive notice of the objects clause of a company.<sup>110</sup> The constructive notice rule deems anyone dealing with a company as having notice of the contents of the public documents filed in the Companies' Registry. The application of the rule was illustrated in *The Commissioner General of Income Tax v Ivory Safaris Ltd*<sup>111</sup> where the Kenyan Commissioner General of Income Tax granted Mr York a clearance certificate enabling him to leave the country on the belief that he was not indebted to the Commissioner. The Commissioner issued the clearance certificate on the strength of a surety bond for Kenya shillings 10, 000 (£100) allegedly signed by Ivory Safaris Ltd. The seal of the surety bond was affixed in the presence of a managing director, rather than in the presence of a director and a secretary or a second director, as required by the constitution of the company. Subsequently, the Commissioner sued Ivory Safaris Ltd for the surety when it appeared that Mr. York was indebted to the Commissioner in a sum of Kenya shillings 3685 (£ 40). The suit was, however, dismissed on the premise that the bond was not valid as its seal was

---

<sup>107</sup> *Percival v Wright* [1902] 2 Ch 421.

<sup>108</sup> *Re City Equitable Fire Insurance Co* [1925] Ch 407.

<sup>109</sup> The ultra vires rule was effectively abolished in the UK by section 110 of the Companies Act 1989.

<sup>110</sup> *Eastern Counties Railway v Hawkes* (1885) 5 HLC 331.

<sup>111</sup> [1972] High Court of Kenya Civil Appeal No 113 of 1971.

affixed in the presence of the managing director, rather than two people, as required by the Articles of Association. The court relied on the principle that the Commissioner, as a person dealing with a limited company, ought to have had notice of the regulation of the company. The court also noted the provisions of Table A, Article 13<sup>112</sup> which reads:

"The directors shall provide for the safe custody of the seal, which shall only be used by the authority of the directors or of a committee of the directors authorised by the directors in that behalf, and every instrument to which the seal shall be affixed shall be signed by the director and shall be countersigned by the secretary or by a second director or by some other person appointed by the directors for the purpose."

However, an outsider is not affected by a defect in the internal management procedures of the company, where the affairs of the company are seemingly conducted in accordance with the constitution of the company. This was illustrated in *Emco Plastica International Ltd v Freeberne*<sup>113</sup> where a company appointed a Secretary by resolution of the board for a minimum term of five years. The managing director signed the letter containing the terms of his employment. When the company purported to dismiss the respondent, before the expiry of his term, he sued for benefits under the contract. The company contended that the managing director did not have the authority to make the contract, as he was not authorised by the board or the company's articles. The court found that the contract was binding, as it was made within the scope of the ostensible authority of the managing director. Finding that the respondent was not obliged to enquire whether the Articles of Association had been complied with, Lutta JA observed:

---

<sup>112</sup> Similarly, Section 180 of the Companies Act was noted: "A provision requiring or authorising a thing to be done by or to a director and the secretary shall not be satisfied by its being done by or to the same person acting both as director and as, or in place of, the secretary." The court relied on *Royal British Bank v Turquand* [1856] All ER 435 and *Panorama Developments (Guildford) Limited v Fidelis Furnishing Fabrics Ltd* [1971] 3 WLR 440.

<sup>113</sup> [1971] EA 432.



“Someone had to represent the appellant company in the conduct of its business, particularly at the initial period, and such person must surely have authority to bind the appellant company. Thus a third party dealing with the appellant company was entitled to assume that there was authority on the part of that person to bind the appellant company. The question as to whether or not the Articles of Association or a resolution of the board empowered the chairman or any other director to enter into a contract binding the appellant company was not a matter into which the third party should have inquired as long as he acted on a representation that the chairman or director had authority to bind the appellant company...the respondent, being the Secretary of the company, was not placed in a position different from that of an outsider, who is entitled to assume in the absence of knowledge to the contrary that a director signing a contract has authority to do so.”<sup>114</sup>

## 2.6 Conclusions

Directors occupy the most important position in a company. As such, whilst their failure to discharge their duties properly can impact on a company negatively, due diligence and efficacy on their part can result in benefits. To ensure that a company realises profits, directors must exercise their powers in the interests of the company rather than their own.

The board of directors, being independent from shareholders, has significant powers to conduct the affairs of the company. Although the autonomy of the boards of private companies helps them to make sound decisions on behalf of companies without unnecessary interference from shareholders and other stakeholders, it is also true that the autonomy can be used for the benefit of individual directors rather than the company. It is because of such risks that the law requires directors to act in the best interests of the company.

---

<sup>114</sup> Ibid at 436.

The autonomy of the boards of private companies is different from that of parastatals. The boards of parastatals are under obligations to obey directives from the ministers and the President. Given that they have no autonomy to determine the policies of parastatals, they tend to be ineffective in the discharge of their duties. This factor, coupled with the failure to have strict restrictions for appointment of directors, has made it possible for miscreant directors, who have been responsible for the insolvency of other companies, to continue serving as directors.

It is now appropriate to move on and examine the obligations that directors owe to their companies. The next chapter addresses this issue.

## CHAPTER THREE

### 3.0 OBLIGATIONS OF COMPANY DIRECTORS

#### 3.1 Introduction

Although Kenyan law makes some provisions regarding the obligations of directors, it is often difficult for directors to know what is expected of them, as some provisions are somewhat uncertain and insufficient, and the scheme of the law is cumbersome. This chapter assesses the clarity, certainty, and sufficiency of the law in preventing breaches of fiduciary obligations and conflicts of interests by directors. It also considers whether Kenyan law allows directors to consider community interests when making decisions in an effort to enhance the reputation of companies.

As investors, shareholders expect companies that they invest in to give them a return on their investment. To achieve this objective, directors of a company seek to maximise the profits of a company because the failure to do so may lead to their dismissal.<sup>1</sup> As observed in Chapter One, contractarian theorists justify wealth maximisation on the basis that the firm is a unit for all bargaining arrangements which the participants in a company seek to use so as to maximise wealth through beneficial bargains. So, shareholders, as participants in a company, are considered by contractarians to have no other objectives apart from profit maximisation. Besides, the firm is considered incapable of having other objectives, such as social responsibility, because it is a nexus of contracts, and not an individual<sup>2</sup> with “motivations and intentions.”

Although stakeholders may suffer when the sole objective of directors is to maximise the wealth of shareholders, contractarian theories do not regard that as a sufficient basis for affording legal protection because corporate stakeholders, such

---

<sup>1</sup> S Griffin, *Company Law: Fundamental Principles*, Third Edition (Pearson, 2000) p 245.

<sup>2</sup> Contractarians define the firm as “a legal fiction which serves as a focus for a complex process in which the conflicting objectives of individuals are brought into equilibrium within a framework of contractual relations.” See Jensen and Meckling, “Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure”, (1976) 3 *Journal of Financial Economics*, 305 at 311.

as creditors and employees, are considered capable of protecting themselves through contracts.<sup>3</sup> This view does not recognise the inequality of bargaining power between rational economic actors within a company. It is for this reason that communitarian theorists regard the company as an entity having both a public role and a private one.<sup>4</sup> The communitarian theory recognises the need to protect non-shareholders on the basis that disparities in bargaining power and lack of information make it impossible for some non-shareholders to protect themselves through contracts.

Whilst profit maximisation may well benefit shareholders, it may also harm them when the profitability of a company suffers because of its bad reputation.<sup>5</sup> The reputation of companies that are not socially responsible can be damaged easily by the widespread consumer activism in the global market. For example, Del Monte Kenya suffered heavy losses when the workers' unions, local NGOs, and the representatives of the Catholic church organised a boycott of its products in Italy, a key destination of the company's products, as a result of the failure on the part of the company to heed the concerns of employees and the local communities.<sup>6</sup> Although Del Monte paid its employees relatively well and offered some social facilities,<sup>7</sup> the wider community felt that the company was not doing enough. As a result of the publicity of the boycott, the company suffered great losses,<sup>8</sup> which could have been avoided by reducing the conflict between the management of the company, its employees, and the community.

In addition to the effect that the failure to take societal interests into account has on the profitability of companies, breaches of duties of directors also affect the overall performance of companies, especially when directors of a company impose on the

---

<sup>3</sup> D Millon, "Communitarianism in Corporate Law: Foundations and Law Reform Strategies", in Lawrence Mitchell (ed), *Progressive Corporate Law* (Boulder, Colorado, 1995) p 3.

<sup>4</sup> M Stokes, "Company Law and Legal Theory" in W Twining (ed), *Legal Theory and Common Law* (Twining ed, 1986) pp 155, 162.

<sup>5</sup> According to the United Nations Conference on Trade and Development (UNCTAD), the environmental consciousness in the developed world contributes to the high number of companies following its "best practice" code. There are only two companies in Africa that are following the code. These are South African companies, South African Breweries and Eskom. See Otieno, "Why Corporate Bodies are Turning Green", *Daily Nation*, September 20, 2001.

<sup>6</sup> The boycott was called off when the company bound itself to invest in social facilities, like schools, health and education to benefit the workers, their families and the neighbouring communities. See "Lobbies call off Products Boycott", *Daily Nation*, 18 March 2001.

<sup>7</sup> Such as housing and education for employees' children and healthcare. See Kent, "CSR Investment is not a Choice" *Ethical Corporation Magazine*, Issue 1, December 2001.

<sup>8</sup> <<http://www.ethicalcorp.com/Magazine/issue1.pdf>>

<sup>8</sup> Ibid.

board decisions that are against the interests of the company. The 1999 audit report<sup>9</sup> on Kenya Tea Development Authority indicated that the decisions of the company to award tenders are usually made outside the boardroom largely because of the interests that directors have in them. The report gave one example where the members of the board became divided over an attempt by some directors to impose a decision on the entire board. To win the support of the directors who dissented, the company which won the tender sponsored a fully paid up trip to Finland for three directors, managing director, two senior officers and two farmers. The audit report also established a host of reasons bedevilling the corporation. These included: irregular tendering and procurement of goods and services, inadequate budget controls, splitting of invoices and under selling of tea, disposals of assets at throw away prices, using company's resources to finance mismanagement in general, especially unnecessary and irregular acquisition of assets. In all, these factors have contributed to the low returns borne by farmers. The returns as a proportion of the value of delivered tea dropped from an all time high of 97 percent in 1993 to 64 percent in 1999. A total loss of 167 million Kenyan Shillings (£1.67 million) was borne by farmers through irregular procurement procedures between 1995/96 and 1998 99 when some 206, 000 metric tonnes of fertilisers were imported.<sup>10</sup>

### **3.2 The Kenyan Context**

As noted in Chapter One, the duties of directors in Kenya are not codified in the Companies Act (the "Act").<sup>11</sup> As such, the principles underlying them are found in the English common law.<sup>12</sup>

#### **3.2.1 The Nature of Responsibilities**

As observed in Chapter Two, duties of directors share some similarities with the duties of trustees.<sup>13</sup> However, whilst trustees of a will or settlement are under a duty to be cautious and to avoid risks, directors must take risks for the purposes of

---

<sup>9</sup> Mogusu, "Audit Report Uncovers Massive Graft at KTDA", *East African Standard*, 1 March, 2000.

<sup>10</sup> Mogusu T, *Ibid*.

<sup>11</sup> Chapter 486, Laws of Kenya.

<sup>12</sup> Section 3 (1) (c), Judicature Act, Cap 8 of the Laws of Kenya.

<sup>13</sup> *Re City Equitable Fire Insurance Co* [1925] Ch 407, per Romer J at 426.

earning profit for the company. As such, the duties of directors embrace not only the fiduciary duties of loyalty and good faith, but also duties of skill and care.<sup>14</sup>

To ensure that companies are administered fairly, Kenyan company law requires directors to act bona fide in the best interests of the company. They are also required to act for proper purposes and not to make secret profits or allow their personal interests to conflict with their duties to the company. These principles are illustrated in the East African Court of Appeal<sup>15</sup> decision in *Trevor Price and Another v Raymond Kelsall*,<sup>16</sup> where the first appellant (Trevor) and the respondent (Raymond) made an oral investment arrangement before incorporation of a company. They agreed to obtain leases of two tea estates and transfer the leases to the company upon incorporation. Raymond successfully applied for the two leases as agreed, and both parties agreed in 1947 to transfer the estates to the company when it was finally incorporated. Despite these arrangements, Raymond intentionally failed to include Kiko estate in their agreement. He (Raymond), however, renewed the lease of Kiko on the strength of a licence which had been issued to the company to plant tea, and developed the estate with the company's money. The lease was issued in his own name rather than the company's. The new lease of Kiko was given in 1953 and it obliged Raymond to plant tea and erect a factory in accordance with the licence held by the company. Trevor learnt in 1956 that Kiko was not held in the name of the company and, therefore, brought an action to protect the company.

The court established that the balance sheets of the company, dating from 1948 onwards, which Raymond had signed, referred to Kiko in their entries. The estate had largely been developed with the funds from the company. Raymond averred that the oral agreement for the transfer of Kiko to the company was made before the incorporation of the company and it could not therefore ratify it when it came into existence.<sup>17</sup>

---

<sup>14</sup> PL Davies, *Gower's Principles of Modern Company Law*, (Sixth Edition, Sweet & Maxwell, 1997), p 599.

<sup>15</sup> The East African Court of Appeal served as a common appellate court for Kenya, Uganda, and Tanzania between 1967 to 1977 when the East African Co-operation (EAC) existed. The EAC was an inter-governmental organisation with the mandate to promote regional integration and development among the three republics.

<sup>16</sup> [1957] EA 752.

<sup>17</sup> The court found that certain circumstances allow it to infer the creation of a new contract, after ratification, to the effect of the previous unratifiable contract. The court adopted the dictum of Jessel, M R, in *Re Empress Engineering Co* (1880), 16 Ch D 125 at 128.

The East African Court of Appeal held that Raymond in his role as a director was in a fiduciary position relative to the company. As such, any benefits he had, he held on a constructive or resulting trust in favour of the company. This was attested to by the fact that Raymond had for years deliberately concealed from the company, its accountant, its auditor, and his co-director, that he had in 1953 obtained a lease of Kiko in his own name. The court<sup>18</sup> observed that Raymond held the title to Kiko on trust for the company because:

"The respondent [Raymond] was in a fiduciary position vis a vis the company from the start; in order to obtain the lease he made use of the licence issued to the company, he spent the company's money on development and in breach of duty acquired a title to Kiko in his own name....If I am wrong in thinking that the respondent [Raymond] stood in a fiduciary position towards the company as a promoter even before its formation, he certainly stood in a fiduciary position vis a vis the company from his appointment as one of its directors and as its resident manager. The respondent [Raymond] was not in a position himself to develop Kiko as a tea estate. In order to obtain the lease, he made use of the licence, which had been issued, not to him, but to the company. In breach of his agreement with the first appellant [Trevor] and the company and in breach of his duty towards the company, he acquired a title to Kiko in his own name concealing that transaction. He spent the company's money on development. He attempted to make out of this a pecuniary advantage for himself. It seems clear to me that a court of equity should decree that he holds the title to Kiko on trust for the company."<sup>19</sup>

Other aspects of the fiduciary duties owed by directors are illustrated in the case of *Flagship Carriers Ltd v Imperial Bank Ltd*,<sup>20</sup> where the directors of Flagship

---

<sup>18</sup> The court followed the judgement in *Erlanger v New Sombrero Phosphate Co* (1878) 3 App Cas 1218 at 1236. The court also referred to *Gluckstein v Barnes* (8) [1900] AC 240 at 256, which relates to promoters as fiduciaries.

<sup>19</sup> *Trevor Price and Another v Raymond Kelsall* [1957] EA 752 at 753, Per Sir Kenneth O'Connor, P.

<sup>20</sup> High Court Civil Case No 1643 of 1999 (Unreported), Ruling per PJS Hewett.

Carriers sought a temporary injunction to restrain its receivers from dealing with any assets of the company. They also sought the appointment of an impartial and competent receiver on the basis that the receivers, appointed under a debenture held by the defendant, had failed to carry out lucrative contracts, failed to manage Flagship's business profitably, and allowed their interests to conflict with those of Flagship. The directors contended that one of the receivers was closely associated with a competitor of Flagship. On the other hand, the receivers averred that the directors had refused to co-operate with them and, in turn, had hidden some vehicles, allowed vehicles to be repossessed by outside financiers, and refused to surrender accounts and the statement of affairs. Finding that the directors were in breach of their obligations, the High Court maintained that directors had obligations to the company and to the receivers to:

“act bona fide in the interest of and for the benefit of the company as a whole...; act for proper purposes and in a proper manner; act in a sense as quasi-trustees for the company assets so that they can, for example, be held liable should they misapply any of the same; not to make secret profits, and to avoid conflicts of interests and duty.”<sup>21</sup>

Dismissing the application, Mr. PJS Hewett, Commissioner of Assize<sup>22</sup> observed that:

“had there been on the evidence one clear proven example of the receivers acting improperly that would have been sufficient... If the company is such a good and valuable operation, why hide some of the vehicles and keep back from the receivers matters which would undoubtedly help them to make a better judgement as to the wisdom or otherwise of continuing the transport business...I am not satisfied that the directors have acted in good faith.”<sup>23</sup>

---

<sup>21</sup> Ibid at 5.

<sup>22</sup> The term refers to a part time judge.

<sup>23</sup> Op cit n 20, at 11.



To permit a conflict of the duties of directors and their personal interests would probably be detrimental for a company,<sup>24</sup> as it encourages competition with the company and misuse of the property,<sup>25</sup> information or opportunity of the company. The rules governing directors will now be considered in turn.

### 3.2.2 *Duty to act in good faith.*

Directors have a duty to act “*bona fide* in what they consider, not what a court may consider, is in the interests of the company and not for any collateral purpose”.<sup>26</sup> While this duty may seem to suggest that a subjective test is invoked to establish honesty, directors may still be liable where they have acted honestly, but failed to direct their minds to the question whether a transaction was in the interest of the company.<sup>27</sup> If directors, for instance, are found not to have acted in the interests of the company, their honesty is irrelevant.<sup>28</sup> Unlike the collective duties of a board of directors, the duties of good faith are owed<sup>29</sup> by each director<sup>30</sup> individually<sup>31</sup> to the company alone.<sup>32</sup>

---

<sup>24</sup> According to the decision in *Movitex Ltd v Bulfield* (1986) 2 BCC 99, 403 at 99, 449 directors do not owe duties to the company not to make unauthorised profits and not to be in a position in which interests and duty conflict. Instead, the no-conflict and no-profit rules allow the courts to give the company a remedy when a director makes any unauthorised profit from the directorship. However, the no conflict and no profit rules are regarded as duties of loyalty in the USA. See Mayson et al, *Company Law* (16th Ed, Blackstone Press, 1999) p 519.

<sup>25</sup> Directors are not allowed to exploit business opportunities specifically rejected by their companies. See *Regal Hastings Ltd v Gulliver* (1967) 2 AC 1347.

<sup>26</sup> *Per* Lord Greene MR in *Re Smith v Fawcett Ltd* [1942] Ch 304.

<sup>27</sup> *Re W & M Roith Ltd* [1967] 1 WLR 443. A pension transaction made by a director solely for his widow was held to be not binding on the company because no thought had been given to the question whether the arrangement was for the benefit of the company.

<sup>28</sup> Bowen LJ in *Hutton v West Cork Railway Co* (1883) 23 Ch D 654 at 671.

<sup>29</sup> Both the Cohen (Cmnd 6659, paras. 86 and 87) and the Jenkins' (Cmnd 1749, paras 89 and 99 (b)) Committees criticised this position and the latter rejected it. The position taken in *Lindgren v L & P Estates Ltd* [1968] Ch 572 suggests that even directors of a holding company do not owe duties to its subsidiary when the latter has an independent board of directors.

<sup>30</sup> Although the duties of directors only attach from the date their appointment takes effect, they extend beyond the end of their appointment. In *Lindgren v L & P Estates Ltd* [1968] Ch 572, a “director-elect” was held not to be in a fiduciary relationship to the company. A director may not detrimentally use any information acquired during the subsistence of an appointment after resignation. See, also, *Industrial Development Consultants Ltd v Cooley* (1972) 2 All ER 162.

<sup>31</sup> PL Davies, *op cit* n 14, p 599

<sup>32</sup> *Percival v Wright* [1902] 2 Ch 421. Directors may, however, stand in a fiduciary relationship to the members if members authorise them to negotiate on their behalf. See *Briess v Wolley* [1954] AC 333; *Peskin v Anderson* [2000] 2 BCLC 1, [2001] 1 BCLC 372.

The case of *Leisure Lodges Limited v Yashvin A Shretta*<sup>33</sup> illustrates the nature of the duty to act in good faith. In that case the respondent, in a petition for winding up, obtained an interim liquidation order from the High Court after satisfying the court that Leisure Lodges Ltd was being managed corruptly, illegally, not for the benefit of all the shareholders, and with the total exclusion of minority shareholders from its management. The respondent, who held ten percent of the company shares, claimed that the directors, who were entirely drawn from the majority shareholders, were:

- Manipulating foreign exchange rates, whereby the income of the appellant company [was] deliberately kept in a secret account in a bank which [was] owned by the families of the majority shareholders.
- Arranging for a part of the revenue of the appellant company to be paid to tour operators in foreign bank accounts controlled by the members of the majority shareholder's family.
- Collecting from foreign debtors of the appellant company money and failing to account for it to the appellant company.
- Collecting monies belonging to the appellant company and failing to account for it.
- Entering into contracts with the hotel and club to supply items, such as TV sets and safes, without disclosing their interests.
- Amending the Articles of Association at the behest of the majority shareholders and permitting new people to become shareholders in disregard of the articles of association.

The Court of Appeal upheld an ex parte order for an interim liquidation order and observed that the directors had failed to act in good faith and as a result the “company’s property was in danger of dissipation, misappropriation, and wasting from those in control.”<sup>34</sup>

---

<sup>33</sup> Civil Appeal No 10 of 1997 (unreported) in Winding Up Cause No 28 of 1996 (Court of Appeal, Kenya).

<sup>34</sup> Per Justice Tunoi PK Civil Appeal No 10 of 1997 (unreported) in Winding Up Cause No 23 of 1996.

For a transaction to be in the best interests of the company, it must be a bona fide one, be reasonably incidental to the carrying on of the business of the company, and be done for the benefit, and to promote the prosperity, of the company.<sup>35</sup>

### 3.3.3 Exercise of power for proper purpose

The duty to act bona fide in the interests of the company requires directors to exercise their powers for the purpose for which they are given and not for collateral purposes. As such, they must keep within the proper limits and avoid using powers given to them for one purpose for a totally different purpose.<sup>36</sup> Any exercise of the powers of directors for an improper purpose can be set aside even though the directors may honestly have believed that they were acting in the interests of the company.<sup>37</sup>

Exercise of power for collateral purposes,<sup>38</sup> as opposed to acting bona fide in the interests of the company, prompted the Court of Appeal in Kenya to make a liquidation order in *Leisure Lodges Limited v Yashvin A. Shretta*<sup>39</sup> on the basis that directors exercised the powers conferred on them for their own benefit.

In the UK, the courts use an objective test<sup>40</sup> to assess whether an intelligent and honest man in the shoes of a director would have “reasonably believed that the transactions were for the benefit of the company.”<sup>41</sup> As such, the objective duty to exercise power for the proper purpose supplements the subjective duty to act in good faith.<sup>42</sup> Given that the objective test is more rigorous than the subjective one, the

---

<sup>35</sup> The test does not apply where the powers of the company are explicit. See *Bell Houses Ltd v City Wall Properties Ltd* [1966] 2 QB 656 CA *Charterbridge Corporation v Lloyds Bank Ltd*, [1970] Ch 62 per Pennycuik J. Eve J limited the application of the test to instances where a company's powers could only be implied. If an intelligent and honest man in the position of a director could have reasonably believed that the transaction were for the benefit of the company, the said act ought to be considered bona fide for the interest of the company.

<sup>36</sup> *Re Camerons Coalbrook Steam Coal, and Swansea and Lougher Railway Co, Bennet's Case* (1854) 5 De GM and G 284 at 298 per Turner LJ.

<sup>37</sup> *Australian Growth Resources Corp Pty Ltd v Van Reesema* (1988) 6 ACLC 529, 538-539 per King CJ.

<sup>38</sup> Directors are not expected to act on the basis of what is for the economic advantage of the corporate entity disregarding the interests of the members. See PL Davies, op cit n 14, p 577.

<sup>39</sup> Civil Appeal No 10 of 1997 in Winding Up Cause No 23 of 1996 (Court of Appeal, Kenya).

<sup>40</sup> The proper purpose test allows the acts of directors to be reviewed by the courts upon a more objective basis than that applies to bona fides. See *Darval* (1989) 7 ACLC 659, 676 per Kirby P.

<sup>41</sup> *Charterbridge Corporation Ltd v Lloyds Bank Ltd* [1970] Ch 62 per Pennycuik J.

<sup>42</sup> In spite of acting honestly, directors may still be held liable if they have exercised their powers for a purpose which is different from the one power was conferred. See *Howard Smith Ltd v Ampol Ltd* [1974] AC 821.

objective duty to act for the best interests of the company has enabled courts to maintain control over boards of directors in English companies, as opposed to other Commonwealth countries.<sup>43</sup>

Since the duty to act in the best interests of the company requires directors to use powers conferred on them by the articles of association, construction of the articles determine the criteria used by the courts to determine whether a particular purpose is proper.<sup>44</sup> In the event that the articles are not explicit, proper purpose, according the decision in *Re The Highlands Commercial Union Limited*, may be implied from the “general obligations and duties which directors incur by the very nature of their appointment.”<sup>45</sup> For instance, when directors are given powers to raise capital through allotment of shares, such allotment would be improper if its sole objective is to ensure that directors or other persons gain control of the company.<sup>46</sup> It is worth noting, however, that the fact that a director’s exercise of power benefits him does not necessarily amount to invalidation of the exercise of power if the benefit accrued was not the dominant purpose.<sup>47</sup> A scenario of such circumstances may arise where the directors’ exercise of a power leads to two or more effects. If the achieving of one effect would be a proper purpose, while achieving the other would be improper, the court determines the overall purpose by considering whether the achieving of what is regarded as improper<sup>48</sup> was the substantial purpose or the dominant purpose.<sup>49</sup>

In all, the proper purpose test fosters the accountability of directors by allowing courts to monitor the directors’ decision-making more closely.

### 3.3.4 *Unfettered discretion*

As trustees of their powers, directors cannot fetter their exercise of powers by agreeing to vote in a particular way at future board meetings. This principle also

---

<sup>43</sup> *Harlowe’s Nominees Pty Ltd v Woodside (Lake Entrance) Oil Co* (1968) 42 ALJR 123.

<sup>44</sup> *Re Smith & Fawcett Ltd* [1942] Ch 304 at 306.

<sup>45</sup> *Re The Highlands Commercial Union Limited* [1957] EA 851, at 858 *Per* Crawshaw J. Directors ought to conduct the affairs of the company in an honest and reasonably business-like manner.

<sup>46</sup> *Hogg v Cramphorn Ltd* [1967] Ch 77, 84.

<sup>47</sup> *Hirsche v Sims* [1894] AC 654; *Richard Brady Franks Ltd v Price* (1937) 58 CLR 112; *Mills v Mills* (1938) 60 CLR 150.

<sup>48</sup> Acting bona fide in the interests of the company cannot absolve a director who has acted for a dominant improper purpose in his own interests. See *Ashburton Oil NL v Alpha Minerals NL* (1971) 123 CLR 614 at 627 *per* Menzies J; *Howard Smith Ltd v Ampol Ltd* [1974] AC 821.

<sup>49</sup> *Whitehouse v Carlton Hotel Pty Ltd* (1987) 162 CLR 285 at 294.

applies where “there is no improper motive or purpose and no personal advantage reaped by the directors under the agreement.”<sup>50</sup> However, where directors are exercising their discretion in good faith and have entered into a contract on behalf of the company, they can agree to take any actions necessary to carry out that contract.<sup>51</sup> Similarly, a nominee director<sup>52</sup> can be appointed to a board of another company by his principal and required to vote in a particular way. To eliminate the effect of such fettering, the law requires nominee directors to ignore the interests of the nominator.<sup>53</sup> Due to the impracticability of such a requirement, Ghanaian Companies Code 1973 requires directors to “give special, but not exclusive, consideration to the interests” of the nominator.<sup>54</sup>

Given that directors would not legally fetter their discretion under most circumstances in Kenya, they are not in a position to benefit from the advantages that the relaxation of the no fettering rule would have. First, it enables companies, just like individuals, to enter into beneficial long-term contracts.<sup>55</sup> Second, the principle allows directors to enter into a contract regarding future advice given to shareholders on a matter within the shareholders' power of decision.<sup>56</sup> In instances where shareholders are dependent upon the advice of their directors, the rule allows directors to give them advice, which reflects the situation as seen, by directors “at the time it fell to the shareholders to take their decision.”<sup>57</sup>

### 3.3 Interests Protected by Directors

#### 3.3.1 *Obligations to the Corporate Entity*

The Act does not specify whether the duty to act *bona fide* in the interests of the whole company<sup>58</sup> requires directors to consider the interests of the corporate entity<sup>59</sup> and present and future members or the company as a whole, including employees.

---

<sup>50</sup> PL Davies, op cit n 14, p 608.

<sup>51</sup> *Thorby v Goldberg* (1964) 112 CLR 597, (Aust HC).

<sup>52</sup> The term refers to a director not elected by the shareholders generally but appointed by a particular class of security holder or creditor to protect their interests.

<sup>53</sup> *Boulting v ACTT* [1963] 2 QB 606 at 626, per Lord Denning MR.

<sup>54</sup> PL Davies, op cit n 14, p 608.

<sup>55</sup> Ibid.

<sup>56</sup> Ibid, p 609.

<sup>57</sup> Ibid.

<sup>58</sup> Evershed MR in *Greenhalgh v Arderne Cinemas* [1951] Ch 286, CA; *Peters American Delicacy Co v Heath* (1939) 61 CLR 457.

Any act considered to be *bona fide* by the director must be geared towards promoting the business.<sup>60</sup> The Kenyan Court of Appeal in *Zephrine Simon Muchunguzi and Others v Geoffrey Makana Asayo*<sup>61</sup> held that it was not in the best interests of the company to allow receivers and managers to manage the affairs of a company due to the exorbitant fees payable to them. In that case, Kenya Commercial Bank appointed the applicants as receivers and managers to sell or manage the assets of Kwanza Motors pursuant to the provisions of a debenture which the company had executed. The respondents, who were shareholders and directors, sought an order to lift the receivership of Kwanza Motors Ltd on the basis that the receivers were not acting in the best interests of the company as a separate entity. The Court of Appeal found that the management of the company ought to revert to the directors. Although this case was concerned with receivers, it clearly illustrates that receivers, as agents of the company, ought to manage the property of a company with due diligence and good faith,<sup>62</sup> as would directors.

Gratuitous payments or gifts out of the assets of the company and provision of a pension to a widow of a former employee<sup>63</sup> have been rendered not to be in the best interests of the company.<sup>64</sup> Similarly, crediting sums to directors as a “bonus” at a time when there were no profits available for such purposes was held in *Re The Highlands Commercial Union Limited*<sup>65</sup> to amount to breach of trust or duty because it was not in the best interests of the company. In *Re The Highlands Commercial Union Limited* the liquidators of the company applied to court under section 270 of the Tanzanian Companies Ordinance for an order requiring the respondents, who were at one time directors of the company, to repay certain sums of money which the liquidators alleged had been wrongfully credited to the accounts of the respondents with the company. The sums were credited to the directors as a

---

<sup>59</sup> In *Greenhalgh v Arderne Cinemas Ltd* [1951] Ch 286, 291, the benefit of the company as a whole was interpreted to mean the corporators as a general body.

<sup>60</sup> “The law does not say that there are to be no cakes and ale, but there are to be no cakes and ale except such as are required for the benefit of the company.” Per Bowen LJ in *Hutton v West Cork Rly*, (1883) 23 Ch D 654 at 672.

<sup>61</sup> Civil Application No NAI 316 of 1997 (Unreported), 16th January 1998, Ruling by PK Tunoi, AB Shah, and GS Pall (Judges of Appeal).

<sup>62</sup> *Medforth v Blake* [1999] All ER (D) 546.

<sup>63</sup> *Re Smith v Fawcett Ltd* [1942] Ch 304 (CA).

<sup>64</sup> *Parke v Daily News Ltd* [1962] Ch 927. A gratuitous payment to the employees of a company who had become redundant on an amalgamation was held ultra vires for not being in the best interest of the company. Gratuitous gifts out of a company’s assets for the purposes of education, charity and politics were allowed in *Evans v Burner Mond & Co* [1921] 1 Ch 359.

“bonus” at a time when there were no profits available for the same. The liquidators alleged that this act constituted a breach of trust.

The Court relied on the provisions of articles 89 to 96 of Table A to the Companies Act to find the directors liable. It particularly singled out article 91 which provides that dividends should not be paid otherwise than out of profits.<sup>66</sup> It also observed that failure to pass any resolution authorising the payment was contrary to the articles, which provided that the remuneration of directors shall be fixed from time to time by the company in general meeting. Due to the fact that not every single possible duty of a director can be contemplated or be provided for in the articles of association, the court observed that reliance must be placed on the general obligations and duties which directors incur by the very nature of their appointment as directors. The Court also recognised that these duties varied according to the nature and size of the business, and noted that they would only vary in degree. Crawshaw J observed, *inter alia*, that:

“It must be implicit, though by implication only, in all cases that their duty in general is to conduct the affairs of the company in an honest and reasonably business-like manner ... It seems to me that as soon as directors are registered as such they immediately become subject not only to the specific provisions of the articles of association but, by implication of law, to the duties and obligations which the very nature of their appointment carries with it, and they must be read as part of the contract.”<sup>67</sup>

Equating the term 'company' with present and future members has not been received well by some commentators.<sup>68</sup> The critique centres on the fact that equating the company with present and future members cannot apply to non-profit companies.<sup>69</sup> While this justification is true in respect of instances where the interests of members only mean the financial interests of members, it cannot apply where the company in question is not a money-making enterprise.<sup>70</sup> Also, it has been argued that equating a

---

<sup>65</sup> [1957] EA 851.

<sup>66</sup> Section 55 (2) of the Act makes a similar prohibition.

<sup>67</sup> *Re The Highlands Commercial Union Limited* [1957] EA 851 at 858.

<sup>68</sup> Instone, “The Duty of Directors” [1979] JBL 221, at 227

<sup>69</sup> *Ibid.*

<sup>70</sup> Birds, “Making Directors do their Duties” [1980] Co Law 67, at 71.

company with present and future employees is undesirable, as it implies that directors would rightly act for themselves in their capacity as shareholders.<sup>71</sup> Although this is partly true, Lord Evershed's definition of "company as a whole" in *Greenhalgh v Arderne Cinemas Ltd*<sup>72</sup> has the effect of invalidating any act favouring one section of shareholders. In view of the controversy relating to interpretation of the term "company as a whole", the British Company Law Review Steering Group proposed that the statutory codification of directors' duties should require directors to "promote the success of the company for the benefit of its members as a whole."<sup>73</sup> The Final Report of the Company Law Review Group recommended that a director should act in what he decides is the way most likely to promote the success of the company. In making such a decision, he is required to consider relevant factors, such as relationships with employees, suppliers and customers, impact on the community or environment or the good reputation of the company.<sup>74</sup>

Unless a company is insolvent,<sup>75</sup> directors owe their duties to the company as a whole. However, this does not imply that directors owe their duties to the shareholders rather than to the company at other times. As such, directors are expected to take wider interests, such as payment of dividends to members, into account since they are "not required by the law to live in an unreal region of detached altruism and to act in a vague mood of ideal abstraction from obvious facts which must be present to the mind of any honest and intelligent man when he exercises his powers as a director."<sup>76</sup>

### **3.3.2 Directors' Responsibility to Constituents**

As noted in Chapter One, although directors owe their duties to the corporate entity, there is a general perception among communitarians that directors should undertake some social responsibilities because a company is "an economic institution which

---

<sup>71</sup> Instone, op cit n 68, 225.

<sup>72</sup> [1951] Ch 286, 291.

<sup>73</sup> Modern Company Law for a Competitive Economy: Developing the Framework (URN00/656) London: DTI, 2000) para 3.51.

<sup>74</sup> The Company Law Review Steering Group: Final Report, (DTI, 2001), Clause 304.

<sup>75</sup> Interests of creditors are paramount then. See *Walker v Wimborne* (1976) 50 ALJR 446; *Multinational Gas and Petroleum Co v Multinational Gas and Petroleum Services Ltd* [1983] Ch 258, per Dillon LJ.

<sup>76</sup> *Mills v Mills* (1938) 60 CLR 150, Aust HC, per Latham CJ at 164.



has a social service as well as a profit-making function."<sup>77</sup> Taking certain community interests into consideration may benefit companies in the long-term. For instance, taking employees interests into consideration might boost their productivity and, in turn, reinforce the profitability of a company. As Mboya notes:

"Co-operation in Kenya between the public and private sectors is not a one-way flow from Government to industry. Private firms are also expected to assume in good faith a number of social responsibilities necessary to effective progress and growing participation of citizens in economic activity."<sup>78</sup>

However, it is notable that obliging companies to perform social roles can also reduce their profitability. This has been the case with the mandatory rural electrification scheme undertaken by Kenya Power and Lighting Company, the Kenya Commercial Bank's plan to open a branch in every district, and Kenatco's provision of security escort services to the entire trucking industry.<sup>79</sup> In a bid to curb losses suffered by such companies, which were all monopolies, the Working Party on Government Expenditure recommended that payment for such social spending be made only by explicit budgetary allocation.<sup>80</sup>

Although communitarians would justify the financing of community benefits by firms with monopolies in the market,<sup>81</sup> contractarians would be against such an initiative on the basis that it reduces shareholder profits, rather than maximising them.

### **3.3.2.1 Obligations to Creditors**

Although the duties of directors are owed to the company, courts have recognised that the interests of creditors ought to be considered when the company is in

---

<sup>77</sup> Dodd, "For Whom are Corporate Managers Trustees?" [1932] 7 *Harvard Law Review* 1145 at 1148.

<sup>78</sup> Hon T Mboya, "The Role of Private Sector in Kenya National Development", in Thomas PA, *Private Enterprise and the East African Company*, (Tanzania Publishing House Ltd, 1969) p 200.

<sup>79</sup> B Grosh, *Public Enterprise in Kenya: What Works, What Doesn't, and Why*, (Reinner Publishers, 1991) p 160.

<sup>80</sup> The 1982 Working Party on Government and Expenditure, Republic of Kenya, 1982, p 42. Cited in B Grosh, *ibid*, p 160

financial difficulties. In such circumstances creditors become major stakeholders because the company may well be trading with the creditors' money.<sup>82</sup> In spite of the protection offered to creditors by contracts, it is important to offer fiduciary protection to creditors so as to ensure that directors are liable if they risk creditors' money in risky businesses.<sup>83</sup>

Although the English common law<sup>84</sup> and the courts of other Commonwealth jurisdictions<sup>85</sup> recognise that directors owe a duty to creditors, the Act and Kenyan courts are yet to recognise this duty.<sup>86</sup> Creditors in Kenya are bound to suffer grave financial loss if directors continue prioritising other interests despite the inability of a company to meet its legal liabilities. As such, it is important to ensure that the assets of a company in such a state are employed to service its liabilities rather than attempting to make profits. Failure to consider the interests of creditors should be a basis of directors' liability.<sup>87</sup>

The codification of this duty should clarify at what point of financial difficulty the duty ought to be triggered.<sup>88</sup> Whilst requiring directors to have regard for interests of creditors while the company is solvent could make them over-cautious and, in turn, interfere with their decision-making, it is also the case that requiring directors to consider the interests of creditors when the company is already insolvent might be of little help to creditors, as they may have already suffered detriment.<sup>89</sup> It is therefore necessary for a codifying clause to strike an appropriate balance between the need to

---

<sup>81</sup> Ibid, p 159.

<sup>82</sup> *Brady v Brady* (1987) 3 BCC 535.

<sup>83</sup> Keay, "The Director's Duty to Take into Account the Interests of Company Creditors: When is it Triggered?" (2001) 25 *Melbourne University Law Review* 315 at 318.

<sup>84</sup> *Lonrho Ltd v Shell Petroleum Co Ltd* [1980] 1 WLR 627; *Brady v Brady* (1987) 3 BCC 535. The Final Report of the Company Law Review Group recommended that a director should consider relevant factors whilst deciding the way most likely to promote the success of the company. The relevant factors may include: relationships with employees, suppliers and customers, impact on the community or environment or the good reputation of the company. See The Company Law Review Steering Group, op cit n 74, Clause 304.

<sup>85</sup> For instance, see *Ring v Sutton* (1980) 5 ACLR 546; *Re Avon Chambers Ltd* [1978] 2 NZLR 638.

<sup>86</sup> Under section 189 (1) (b) (ii) of the Act, a director may be disqualified for fraud or breach of duty if the company is in the course of winding up.

<sup>87</sup> Section 214 of the British Insolvency Act requires a director or a shadow director of a company in liquidation to consider the interests of creditors. Failure to do so may make a director liable to contribute to the assets of the company if the director knew or ought to have concluded that the company had no reasonable prospect of going into insolvent liquidation and failing to take every step to minimise loss to creditors. See Hicks, "Disqualification of Directors-Forty Years On" [1988] JBL 27 at 46.

<sup>88</sup> Keay, op cit n 83, at 318.

protect creditors and allow directors to perform their duties without unnecessary interference. As Professor Andrew Keay suggests:

"the most appropriate trigger would be where the circumstances of a company are such that its directors know, or can reasonably expect, that the action upon which they are going to embark could lead to the insolvency of the company. If this were adopted, then the point of liability would not be the same across the board as the court would have to take into account the circumstances of each company, so that the more obvious it is that the creditors' money is at risk, the lower the risk to which directors are justified in exposing the company."<sup>90</sup>

### **3.3.2.2 Obligations to Employees**

To a certain extent, some companies already consider interests of employees by encouraging them to purchase shares, offering gratuities, and medical attention.<sup>91</sup> Although the Act has no provisions requiring directors to consider the interests of employees,<sup>92</sup> directors can still take such interests into consideration if the interests are reasonably incidental to the carrying on of the business of the company.<sup>93</sup> However, taking the interests of employees into account is unlawful if doing so conflicts with the interests of a company.<sup>94</sup> Despite these considerations, failure to formulate statutory obligations requiring directors to perform social duties increases social injustice and exploitation.

Although employees have a right to join trade unions, their capacity to make demands from companies is undermined by discretionary powers that the Minister for Labour has to declare strikes illegal.<sup>95</sup> As such, the efficacy of trade unions as

---

<sup>89</sup> Ibid at 329.

<sup>90</sup> Ibid at 334.

<sup>91</sup> PA Thomas, op cit n 78, at 29.

<sup>92</sup> Sections 309 and 659 of the British Companies Act require directors to consider the interests of employees.

<sup>93</sup> "Can anything be more reasonable than that when employers have had a good year they should encourage the workmen to increased exertions?" *Per* Jessel MR in *Hampson v Price's Patent Candle Co* (1876) WR 754. See, also, *Hampson v Price's Patent Candle Company* (1876) 45 LJ Ch 437

<sup>94</sup> Instone, "The Duty of Directors" [1979] JBL 221, 228-230.

<sup>95</sup> Trade Disputes Act, Cap 234, Laws of Kenya.

representatives of employees is questionable. Employees are also vulnerable because there is no statutory protection which permits directors to offer compensation by making *ex gratia* provision for employees.<sup>96</sup> Moreover, directors are not under any obligation to establish pension schemes for employees or to safeguard the long-term interests of employees by running a company efficiently.

It is notable that, both British<sup>97</sup> and Ghanaian<sup>98</sup> companies legislation, require directors to have due regard to the interests of employees of the company. However, section 309 of the British Companies Act has rarely been invoked in Britain because the duty is not enforceable by employees, as it is owed to the company.

Although requiring directors to consider employees' interests might be beneficial to workers, the British Company Law Review Steering Group deems such a requirement unnecessary because consideration of the interests of employees undermines the principle of shareholder supremacy.<sup>99</sup> Although such a requirement might undermine the supremacy of shareholders to some extent, there is a need to recognise and protect such class interests<sup>100</sup> within the public because of the inequality of the bargaining power between the employees and the company. Although contractarians argue against such protection, it is submitted that they

---

<sup>96</sup> This is allowed in the UK. See section 719 of the Companies Act 1985 and section 187 of the Insolvency Act 1986.

<sup>97</sup> Sections 309 and 659 of 1985 Act. Before the enactment of this provision, it would have been considered ultra vires for a director to take into considerations the interests of employees. See *Parke v Daily News Ltd* [1962] Ch 927.

<sup>98</sup> Section 179 of the Ghanaian Companies Code provides: "In considering whether a particular transaction or course of action is in the best interests of the company as a whole, a director when appointed by or as a representative of a special class of members, employees or creditors may give special, but not exclusive, consideration to the interests of that class".

<sup>99</sup> The group avers that employees' interests should only be considered if they promote shareholders' interests. As such, section 309 of the Companies Act 1985 is regarded as undesirable. See *Modern Company Law for a Competitive Economy: the Strategic Framework* (London: DTI, 1999) Paras 5.1.20 to 5.1.23. Reacting on the proposals made by the Commission on Public Policy and British Business, *Promoting Prosperity: a British Agenda for Britain* (London: Vintage, 1997), the Company Law Review Steering Group also felt that such a requirement would make directors unaccountable to anyone. See Committee on Corporate Governance, *Final Report*, (London: Gee, 1997) Para 1.17.

<sup>100</sup> Many States of the USA have enacted enabling provisions for directors to consider interests of employees, customers, creditors, suppliers, and the communities in which they operate. For instance, it is possible for a company to use such provisions in defence of a hostile take over bid where the company raider is unlikely to consider such interests. See Mayson et al, op cit n 24, p 519 See, also: Dodd, "op cit n 77, at 1145; White, "How Should we talk about Corporations? The Language of Economics and of Citizenship" (1985) 94 Yale LJ 1416.

assume wrongly that workers are in a position to protect themselves through the contracts entered into with the company.<sup>101</sup>

The Nigerian Law Reform Commission also declined to recommend the adoption of a provision obliging directors to have regard to the interests of employees on the basis that it would affect adversely the developing economy of the country and, in turn, lead to loss of jobs, as the requirements would deter foreign investors.<sup>102</sup> Although this might be true in part, it should be borne in mind that foreign companies are not always factors in the promotion of developing economies, as their success is usually at the expense of local companies and the economy. In fact, direct and indirect employment gains made by foreign companies may be offset by induced job losses in the local companies.<sup>103</sup> Besides, the failure to consider the interests of employees affects their productivity and, in turn, the performance of a company. In view of the long-term employee loyalty<sup>104</sup> that companies would enjoy, if directors took employees' interests seriously, the initiative of considering employees' interests would ultimately be in the best interests of companies. In fact, 57 percent of respondents to a survey conducted in Nairobi in 2001-2002 (the "Survey")<sup>105</sup> felt that directors ought to consider social responsibilities so as to facilitate participation of employees in economic activities.

The interests of employees that might need to be respected by a company include: consideration and consultation expectations; financial matters, such as salary and pensions; and the opportunity to enjoy continued employment with the business.<sup>106</sup> Requiring directors to have regard to the interests of employees would not be difficult to implement because there already exists some legislative measures to the same effect. Such legislative measures regulate "minimum wages, maximum hours,

---

<sup>101</sup> D Millon, op cit n 3, p 3.

<sup>102</sup> Nigeria Law Reform Commission, *Working Papers on the Reform of Nigerian Company Law: Volume 1- Review and Recommendations*, 1987 pp 203-204.

<sup>103</sup> Griffiths & Wall, *Applied Economics: An Introductory Course*, Sixth Edition, (London and New York: Longman, 1995), p 158.

<sup>104</sup> In Japan, the much praised and successful 'just-in-time' (or Kaban) production processes and 'quality circles' rely on employees loyalty to their companies. This loyalty is reinforced by lifetime employment and a shared set of values, which emphasise collectivism. See Griffiths & Wall, *Ibid*, p 156

<sup>105</sup> The survey data is analysed in detail in Chapter 9.

<sup>106</sup> D Milman, "From Servant to Stakeholder: Protecting the Employee Interest in Company Law", in D Feldman and F Meisel (eds), *Corporate and Commercial Law: Modern Developments*, (Lloyds of London Press, 1996) p 147.

employment of women, children and young persons, industrial accidents, hospitalisation, and payment in cash as opposed to kind."<sup>107</sup>

### 3.3.2.3 Donations

Given that donations made by a company may enhance its image,<sup>108</sup> it may be argued that some donations further the interests of the company as a whole. Such wider interests remain *intra vires* the company since "the law does not say that there are to be no cakes and ale except such as are required for the benefit of the company."<sup>109</sup>

Although donations can further the interests of a company, they can also be detrimental to its well-being. It is notable that thirty-nine percent of respondents in Question 2 of the survey questionnaire felt that donations encourage corruption. Fifteen per cent of respondents felt that donations enhance the image of companies and 46 per cent took the view that donations promote certain purposes, such as charity and education. Those who felt that donations encourage corruption attributed their views to the fact that directors of parastatals in Kenya are known to give donations for political reasons in return for political favours, such as appointment to lucrative government positions.<sup>110</sup> In fact, KCC (Kenya Co-operative Creameries) (in receivership), which has given large donations, has been a good springboard into political positions, as many of its former directors have gone on to become Members of Parliament.<sup>111</sup>

As a safeguard against abuse of donations, there is a need to limit the amount of money that can be donated by directors, oblige directors to disclose donations in the accounts of the company,<sup>112</sup> or require the consent of shareholders to be given before substantial donations are made.

---

<sup>107</sup> PA Thomas, op cit n 78, p 22. Such legislation includes: The Employment Act, Cap 226, The Employment of Women, Young Persons and Children Act, Cap 227, The Regulation of Wages and Conditions of Employment Act, Cap 229, The Shop Hours Act, Cap 231, The Workmen's Compensation Act, Cap 236, and The Factories Act, Cap 514.

<sup>108</sup> *Evans v Burner Mond & Co* (1921) 1 Ch 359.

<sup>109</sup> *Hutton v West Cork Rly* (1883) 23 Ch D at 673 Per Bowen L J.

<sup>110</sup> Appointments to parastatal directorships are made by the President and Ministers.

<sup>111</sup> "Politics is killing the dairy industry", *Market Intelligence Business and Finance Journal*, June 21, 2000 <<http://www.mi.co.ke/archive/september/industry.html>>

<sup>112</sup> In the UK companies have a statutory duty to disclose donations for political purposes in excess of £ 200 in the report of directors. See Companies Act 1985, s. 235.

### 3.3.2.4 Multinational Corporations

Although multinational companies create employment and enhance the transfer of technology to host countries, they also contribute to low standards of health, safety, and environment by transferring environmentally unsound production systems<sup>113</sup> and materials.<sup>114</sup> At the moment there is no institution, at either national or international level, that is endowed with the responsibility of regulating the activities of multinationals.<sup>115</sup> As a result, multinational corporations in Kenya rarely adopt the same responsibilities that they have in other countries. This view was supported by 45 per cent of respondents in the survey. Only 33 per cent of respondents felt that multinational corporations assumed such responsibilities. The remaining 22 per cent had no view on the matter.

Given that the influx of multinationals partly undermines the economic sovereignty of Kenya, the failure to require them to take societal interests into consideration does not foster the economy of Kenya. In spite of the positive contributions multinationals make to the economy of Kenya, failing expressly to oblige them to honour societal interests is both biased and discriminatory<sup>116</sup> because it exonerates many of them from standards that they have to meet in other countries.

Such discrimination is an attack on the fundamental principle underlying the State's obligations under the International Covenant on Economic, Social and Cultural Rights (ICESCR)<sup>117</sup> and Universal Declaration of Human Rights 1948, which is

---

<sup>113</sup> Multinational companies in oil production, road transport, Chlorofluorocarbon (CFC) production, electricity generation, metals production and agriculture account for roughly 50% of the greenhouse gas emissions. See, "Treaty on Transnational Corporations: Democratic Regulation of their Conduct", The NGO Alternative Treaties (NGO Steering Committee to the UN), Global Forum, Rio de Janeiro, June 1-15, 1992. <<http://www.igc.org/csdngo/alttreaties/AT16.htm>>

<sup>114</sup> Multinational corporations have been involved in transferring to Africa unsafe pesticide and drugs banned in the countries of origin, polluting industries, dumping of radioactive waste, adopting lower safety standards leading to disasters, such as the Bhopal disaster in India.

<sup>115</sup> "Treaty on Transnational Corporations: Democratic Regulation of their Conduct", The NGO Alternative Treaties (NGO Steering Committee to the UN), Global Forum, Rio de Janeiro, June 1-15, 1992 <<http://www.igc.org/csdngo/alttreaties/AT16.htm>>

<sup>116</sup> Article 26 of ICCPR states that all persons are entitled without any discrimination to the equal protection of the law and that "the law shall ... guarantee to all persons equal and effective protection against discrimination on any ground such as race, colour, sex, language, religion, political or other opinion, national or social origin, property, birth or other status."

<sup>117</sup> Australia ratified the Covenant on 9 December, 1975, Kenya on 30 April, 1972, Nigeria on 28 July, 1983, UK on 19 May, 1976, Japan on 20 June 1979, Germany on 16 December 1973, France on 30 November 1980 etc. Ghana and USA, in spite of its many multinational corporations, have not ratified the Covenant. See Amnesty International - Report - AMR 51/18/99, March 1999, United States of America; 1999 UN Commission on Human Rights: "Making Human Rights Work: Time to

given treaty effect by the International Covenant on Civil and Political Rights (ICCPR).<sup>118</sup> The ICESCR guarantees "the right of everyone to form trade unions and join the trade union of his choice, subject only to the rules of the organisation concerned, for the promotion and protection of his economic and social interests."<sup>119</sup> On the other hand, ICCPR provides that human rights are everyone's birthright and apply to all without distinction. Since the protected rights under ICCPR<sup>120</sup> include the social rights of employees,<sup>121</sup> the present laws and practices are not in conformity with the covenant.<sup>122</sup> Conformity with human rights international standards can only be achieved by obliging companies to consider the economic interests or rights of employees.<sup>123</sup>

Multinational companies should also be required to have regard to community interests because of the difficulties encountered by litigants affected by the acts of the companies.<sup>124</sup> In most cases, litigants are unable to sue multinational

---

Strengthen the Special Procedures Appeal Case: United States of America."

[http: www.amnesty.org ailib aipub 1999 AMR.25101899.htm](http://www.amnesty.org/ailib/aipub/1999/AMR.25101899.htm); United Nations High Commissioner for Human Rights < [http: www.unhchr.ch/pdf/report.pdf](http://www.unhchr.ch/pdf/report.pdf)>

<sup>118</sup> The General Assembly of the United Nations adopted the Covenant in 1966, 20 years after the adoption of the Universal declaration. The intervening period was taken up by the member states of the United Nations to work out detailed treaty provisions, which might best give effect to the principles of the Declaration in their different legal systems. The Covenant came into force in March 1976. By virtue of Articles 28 to 32, The Human Rights Committee supervises the implementation of the Covenant. Article 40 requires States parties to submit regular reports on the measures they have adopted which give effect to the Covenant rights and on the process made in the enjoyment of those rights. *This exercise helps in the evaluation of the compliance of each state party with the obligations it has undertaken under the covenant.* See Lallah, "Notes on the International Covenant on Civil and Political Rights and Some of its Case Law" [1992] 18 CLB 1276, at 1278.

<sup>119</sup> Article 8, Clause 1. Article 7 obliges the State Parties to the convention to "recognise the right of everyone to the enjoyment of just and favourable conditions of work which ensure, in particular: remuneration which provides all workers, as a minimum, with: fair wages; a decent living; safe and healthy working conditions; equal opportunity for everyone to be promoted in his employment to an appropriate standard; rest; and leisure."

<sup>120</sup> Most countries have ratified the Covenant. The USA, for instance, ratified it in 1992.

<sup>121</sup> The preamble to the International Covenant on Economic, Social and Cultural Rights states that "the ideal of free human beings enjoying freedom from fear and want can only be achieved if conditions are created whereby everyone may enjoy his economic, social and cultural rights, as well as his civil and political rights."

<sup>122</sup> The international instruments that bear direct relevance to Kenya are; Universal Declaration of Human Rights, ICCPR, European Convention on Human Rights (Kenyan bill of rights was modelled using it), and the African Charter on Human and Peoples' Rights. See J Palamagamba, *Human Rights Jurisprudence in East Africa: A Comparative Study of Fundamental Rights and Freedoms of the Individual in Tanzania, Kenya and Uganda*, (1 Aufl Baden-Baden: Nomos Verl-Ges, 1995) p 27.

<sup>123</sup> In some instances, it might not be easy for employees to prove that directors have not given their interests adequate consideration. For instance, it is possible for directors' meetings to be minuted to the effect that due consideration was given to the views and interests of the employees. See Boyle, "The Companies Act 1980 (4)" [1980] 1 Co Law 280 at 284.

<sup>124</sup> "Regulatory agencies experience considerable difficulty in international cases in terms of detection, evidence, prosecution, jurisdictions, sanctions and co-operation between authorities and governments." See M Punch, *Dirty Business: exploring corporate misconduct*, (London : Sage,



companies<sup>125</sup> in foreign courts, due to difficulties relating to choice of forum and choice of applicable law.<sup>126</sup> For instance, in *Re Union Carbide Corporation Gas Plant Disaster at Bhopal, India in December 1984*,<sup>127</sup> the victims of a lethal gas leak were denied the opportunity to sue the American subsidiary in the courts of the United States despite there being evidence that complainants were unlikely to achieve an adequate and just solution in the Indian courts, due to lack of commitment on the part of the Indian Government to take tough action against the Corporation.

Given that there is no system to provide a readily available source of funds from which compensation can be paid,<sup>128</sup> failure to oblige companies to consider social interests and the inability of affected victims to sue the companies in appropriate fora works against good corporate responsibility in Kenya.

Whilst international human rights law protects any legal person from abuse of its rights by a state,<sup>129</sup> the legal person is not required to observe similar standards in the course of its business. As a result, a multinational corporation can only be subjected to international rights and duties by virtue of a Convention between states because a Convention can oblige state authorities to protect individuals from one another.<sup>130</sup>

---

1996). Cited in J Moran, "Bribery and Corruption: the OECD Convention on Combating the Bribery of Foreign Public Officials in International Business Transactions", [1999] 8, (3) *Business Ethics: A European Review*, 141 at 142.

<sup>125</sup> Since multinational companies comprise of a series of national companies or branches, they do not have separate legal personality at international law. See Brownlie, *Principles of Public International Law* (4th ed, 1990) p 67. Cited in Muchlinski, "The Accountability of Multinational Enterprises and the Right to Development: The Compensation of Industrial Accident Victims from Developing Countries," [1993] *Third World Legal Studies*, 189 at 190.

<sup>126</sup> Difficulties that prevent plaintiffs from compensation include: whether the foreign parent company should be responsible for the acts of its subsidiary and whether liability should be strict or based on fault; failure of the of the corporation to meet its liability as a result of being underinsured; over protection of respective nationals by home and host countries that may undermine legal impartiality. A host country, for instance, may fail to support litigation against a foreign corporation on the basis that such an act would be construed to be hostile towards foreign investors. See Muchlinski, op cit n 125, at 194.

<sup>127</sup> MDL Docket No 626, US District Court, Southern District of New York, Ordered November 8, 1985.

<sup>128</sup> Op cit n 126, at 194.

<sup>129</sup> Article 1, Protocol 1 of the European Convention on Human Rights provides that every natural or legal person is entitled to the peaceful enjoyment of his possessions. See, also, Muchlinski, op cit n 125, at 190.

It therefore follows that the only acts of directors which amount to a violation of international human rights law are international crimes<sup>131</sup> committed on behalf of a private legal person.<sup>132</sup> As such, common breach of the duties of directors cannot be enforced under this head.

Although it has been argued that “constitutionally protected fundamental human rights, whose main purpose is to protect the individual from the State, can also be invoked in relations between individuals, particularly against large-scale private organisations holding considerable economic and social power”,<sup>133</sup> lack of any authority to establish this desired position continues to make individual applications directed against private persons of no effect.<sup>134</sup>

Given that the Act does not specify in whose interests directors are supposed to act and to whom they owe their duties, there is a need for the Act to define expressly the term “company as a whole” to mean the interests of all shareholders or other requisite interest groups, such as employees, creditors, and the society within which the company operates. The drafting may follow the developments in the USA, where courts have held that a board of directors owes duties not only to shareholders, but also to the corporate enterprise, including creditors, when the company is in the vicinity of insolvency.<sup>135</sup> Also, some states in the USA have passed legislation requiring directors to consider non-shareholder interests. Effecting such changes would effectively deal with the problem associated with the interpretation of the said term and subsequently enable directors to ascertain their obligations easily.

---

<sup>130</sup> Article 17 and 13 of the European Convention on Human Rights. See, also, Muchlinski, *ibid*, at 192.

<sup>131</sup> Examples of the crimes include genocide and other war crimes.

<sup>132</sup> The Nuremberg Trial considered *Gestapo* and *SS* to be criminal organisations. See Brownlie, *Principles of Public International Law* (4th ed, 1990) p 561-564. Cited in Muchlinski, *op cit* n 125, at 190.

<sup>133</sup> A Drzemczewski, *European Human Rights Convention in Domestic Law* (Oxford University Press, 1983) Ch 8; Muchlinski, *ibid*, at 191.

<sup>134</sup> Article 25, European Convention on Human Rights.

<sup>135</sup> *Credit Lyonnais Bank Nederland NV v Pathe Communications Corporation* (Unreported, Delaware Court of Chancery, Chancellor Allen, 30 December 1991). Cited in Keay, *op cit* n 83, at 326.

### 3.4 Corrupt Practices

Given that corruption contributes to the stagnation of an economy, inadequate physical and social infrastructure, and poorly functioning political systems,<sup>136</sup> the failure to curb corrupt practices in Kenya<sup>137</sup> has contributed to loss of foreign investment and general economic instability.<sup>138</sup> In fact, investors prefer to do business in less corrupt countries, such as Uganda.<sup>139</sup>

To reverse this trend the Kenyan Government in 2000 tabled a bill, entitled the Anti-Corruption and Economic Crimes Bill 2000, which intended to repeal the Prevention of Corruption Act. Section 3 of the Prevention of Corruption Act, Cap 65, Laws of Kenya, defines corruption as “receiving, agreeing to receive, or soliciting some form of material advantage from someone for the performance or non performance of their public duty.” Given that this definition is only limited to public bodies and public servants, the Kenya Anti-Corruption and Economics Crimes Bill 2000 seeks to widen the scope of the definition to include the private sector.<sup>140</sup> Under the bill, directors are not only required not to compromise the interests of companies by accepting gifts or donations, but they are under a duty not to corrupt others with donations irrespective of their intended benefits to the company. Breach of these duties has the effect of terminating the services of perpetrators<sup>141</sup> and barring them from holding office for 10 years.

While it may be partly true to say that any benefit that accrues to a company is “reasonably incidental to the carrying of the company’s business.... and is done for

---

<sup>136</sup> Kimberly, "The Problem of Corruption: A Tale of Two Countries (Kenya, Uganda)", [1998] 18, (12) *Northwestern Journal of International Law & Business*, 524 at 524.

<sup>137</sup> "Corrupt practices abound within government offices, corporate bodies, private institutions." See K Kibwana et al (ed), *The Anatomy of Corruption in Kenya: Legal, Political, and Social Economic Perspectives*, (Nairobi: Claripress, 1996) p 34.

<sup>138</sup> When the International Monetary Fund (IMF) suspended lending to Kenya in 1997, the IMF and World Bank approved Uganda, due to its reforms strategy, to benefit from the Highly Indebted Poor Countries (HIPC) initiative. As a joint initiative of the World Bank and the IMF, HIPC assists highly indebted poor countries that have a track record of servicing their debts and implementing sound economic policies. See A Boote & K Thugge, *Debt Relief for Low-income Countries: The HIPC Initiative*, IMF Pamphlet Series No 51, at 15-16 (1997). Cited in Kimberly, op cit n 136, at 530.

<sup>139</sup> Uganda's economy grew by an average 6.6% annually between 1990 and 1995. This is one of the highest rates of growth in sub-Saharan Africa. See Kimberly, *ibid*, at 529.

<sup>140</sup> Hon A Wako, "The Kenya Anti-Corruption Bill 2001: Memorandum of Objects and Reasons." <<http://www.lawafrica.com/specials/memorandumofobjects.htm>>

<sup>141</sup> The Bill covers all public officials, including Chief Executives and even heads of departments in state corporations. See "Ethics Bill to curb graft in public service", *Daily Nation*, 29 June, 2000.

the benefit of and to promote the prosperity of the company”,<sup>142</sup> there can be no doubt that benefits procured through corrupt means by directors amount to breach of their fiduciary duties. This is because directors are under a duty not to “abuse their office, engage in bribery, fraud, embezzlement, misappropriation of public funds, and breach of trust.”<sup>143</sup>

Although contractarian theorists might justify pursuit of corrupt practices by directors on the basis that the objectives of the firm are to maximise profits,<sup>144</sup> rather than acting in a socially responsible manner, there can be no doubt that corrupt practices cannot be pursued for the proper purpose because they undermine the economic well being of the country.<sup>145</sup> Thus, acting on the basis of what is for the economic advantage of the company in such circumstances may not only be detrimental to the country but also to the company. This is because the profitability of companies is also affected by the well being of the national economy.

Besides, it can be argued that *corrupt practices by directors are not in the interest of the company on the basis of their illegality*. The articles of association cannot confer powers on directors to pursue illegal practices. Given that directors are required to exercise their powers for the purpose for which they are given and not for collateral purposes, there can be no doubt that corrupt practices by directors do not fall within lawful objectives of the articles of association.

Directors of parastatals are more prone to breach of their fiduciary duties due to the overwhelming discretion and control the government has over appointments of directors and the operation of parastatals.<sup>146</sup> As such, countries with more open and market-oriented economies are likely to experience less instances of corruption than their counterparts with more closed and regulated economies.<sup>147</sup> Similarly, countries

---

<sup>142</sup> Per Eve J in *Re Lee, Behrens and Co Ltd* [1932] 2 Ch 46 at 51.

<sup>143</sup> The Anti-Corruption and Economic Crimes Bill 2000 defines corruption in these terms.

<sup>144</sup> Jensen and Meckling, op cit n 2, at 311.

<sup>145</sup> Corrupt practices of great magnitude can threaten international peace and prosperity, facilitate drug trafficking, money laundering, and distortion of international trade. See Kimberly, op cit n 136, at 524.

<sup>146</sup> Kimberly, *ibid*, at 525.

<sup>147</sup> According to an index of corruption prepared by Transparency International (TI) in mid 1990s, Nordic countries, New Zealand, Canada, and other European countries were listed as the least corrupt. However, developing countries and economies in transition, such as Russia and China are listed as the most corrupt. (TI is a Berlin based non-governmental organisation established in 1993 to

with stronger democratic frameworks are less prone to corrupt practices, as politicians are more accountable to voters and policy-making processes are more transparent.<sup>148</sup>

The high level of corruption in developing countries is often attributed to: low public-sector wages; poverty; illiteracy which makes it easier for literate directors and managers to exploit others; inadequate management controls and lack of adequate technology for monitoring; poor recruitment and selection procedures (including nepotism); poor working conditions and facilities; lack of public information; and inadequate capacity to meet the demand for government services.<sup>149</sup> Similarly, social attitude towards government institutions fuels corruption because in new post colonial states “the idea of national interest is weak ... [and] the state and its organs were identified with alien rule and were proper objects of plunder.”<sup>150</sup>

The lack of clarity in the rules governing fiduciary obligations and poor enforcement policies by the Attorney General and the Judiciary also help to entrench corruption in Kenya. For instance, in the early 1990s, the Government lost \$ 400 million in public funds to a company, Goldenberg International Ltd, trading gold and diamonds that Kenya does not produce. Although some directors have been prosecuted, some senior government officials in charge of the Ministry of Finance and the Central Bank have not been investigated.<sup>151</sup> In that case, a Nairobi company, Goldenberg International Ltd, requested from the Ministry of Finance sole rights to export diamond jewellery and gold from Kenya. The company asked for a grant of 35 per cent export compensation on these items instead of the 20 per cent provided for under the Local Manufacturers (Export Compensation) Act.<sup>152</sup> Despite the statutory requirement, the Ministry of Finance approved payment at the rate of 35

---

combat corruption around the world). See Freedom House, *Freedom in the World: The Annual Survey of Political Rights and Civil Liberties, 1995-1996* (1996). Cited in Kimberly, op cit n 136, at 526.

<sup>148</sup> The extent to which political rights and civil liberties are protected has a correlation to how transparent and accountable policy making processes are. See Ibid p 526.

<sup>149</sup> L Rance, *Bureaucratic Corruption in Asia: The problem of incongruence between Legal Norms and Folk Norms*. Cited in Kimberly, op cit n 136, at 527

<sup>150</sup> Colin, "What is the Problem about Corruption?" 3 *Journal of Modern African Studies*, 215, 224 (1965). Cited in Kimberly, op cit n 136, at 527.

<sup>151</sup> Holman & Wrong, "Moi Weighs Tough Corruption Probe", *Financial Times*, 28 July, 1997.

<sup>152</sup> Cap 482, Laws of Kenya.

per cent. Subsequently, the Auditor General declared the additional 15 per cent payment illegal.<sup>153</sup> He questioned the payment on the basis that gold and other precious metals did not originate from Kenya. As a result, the Parliamentary Public Accounts Committee<sup>154</sup> recommended the recovery of the payment and investigations of the circumstances under which the entire compensation was paid. The initial failure on the part of the Attorney General to prosecute those implicated in the scandal prompted the Law Society of Kenya to institute a private prosecution. Although the Attorney General subsequently took over the proceedings and prosecuted some directors, cases of the individuals who were prosecuted are still pending in court.<sup>155</sup>

Another case that illustrates gross corruption is the awarding by the Government of the contract to construct Turkwel Gorge dam without competitive tender. The project cost many times its original estimate due to kickbacks paid to government officials. As a result, international donors declined to fund any other power projects in Kenya, leading to inadequate capacity and frequent power failures.<sup>156</sup>

Most corrupt practices arise when directors allow their interests to conflict with those of the company. This may arise, for instance, when directors compete with a company or use the property or information of a company to benefit themselves. Corrupt practices also arise when directors contract with a company and when they accept or give bribes. These instances are analysed in the following section.

#### **3.4.1 Use of a company's Property, Information or Opportunity**

A director who benefits from having personal interests that conflict with his duties to the company can be held liable to account for the losses suffered by the company.<sup>157</sup> Since his judgement is likely to be biased when there is a conflict, losses incurred by the company as a result of the conflict are recoverable, at the instance of the company. For instance, in *Leisure Lodges Limited v Yashvin A*

---

<sup>153</sup> Report of the Controller and Auditor General for the Year 1990/91 cited in K Kibwana et al (ed), op cit n 137, p 90.

<sup>154</sup> Deliberations of the Public Accounts Committee (PAC) regarding Government of Kenya Accounts for the Years 1990/91 and 1991/92 in K Kibwana et al (ed), op cit n 137, p 92.

<sup>155</sup> "Appear for your Cases, Goldenberg Group Told", *Daily Nation*, 11 April, 2002; Thoya, "Chief Justice Declares Goldenberg Scam Debate "Contemptuous", *Daily Nation*, 24 July 1999.

<sup>156</sup> Wrong, "Defiant Kenya is running out of Steam", *Financial Times*, 25 October, 1995.

*Shretta*<sup>158</sup> the respondent, in a petition for winding up, obtained an interim liquidation order from the High Court on the basis that Leisure Lodges Ltd was being managed corruptly, illegally, not for the benefit of all the shareholders, and with the total exclusion of minority shareholders from its management. It was contended that directors put the “company’s property.... in danger of dissipation, misappropriation, and wasting”<sup>159</sup> by allowing their own interests to conflict with the interests of the company. The supply of TV sets and safes by directors to a hotel owned by the company was held to constitute a breach occasioned by a conflict of interests, as they had failed to disclose their interests. For that reason, the Court of Appeal upheld an ex parte order for an interim liquidation order and observed that the directors had failed to act in good faith.

Making substantial profits through the sale of shares, for which the company was unable to subscribe fully, rendered the directors of the company liable in *Regal Hastings Ltd v Gulliver*.<sup>160</sup> The basis of liability was that the directors utilised their position and knowledge to profit themselves. It was irrelevant that the directors had entered into the transaction in good faith.<sup>161</sup> The important issue was whether their actions were related to the affairs of the company and whether they utilised their opportunities and special knowledge as directors. Besides, it was also important to establish whether their actions resulted in a profit for themselves.<sup>162</sup>

In addition to being unlawful for a director to benefit from the exploitation of a business opportunity rejected by a company, he is under a duty to disclose to the company the opportunity obtained, which he must not utilise even if the company either is unable to pursue the opportunity or rejects the opportunity.<sup>163</sup>

---

<sup>157</sup> *Boardman v Phipps* [1965] Ch 992 at 994, per Lord Denning.

<sup>158</sup> Civil Appeal No 10 of 1997 in Winding Up Cause No 23 of 1996 (Court of Appeal, Kenya).

<sup>159</sup> Per Justice Tunoi PK Civil Appeal No 10 of 1997.

in Winding Up Cause No 23 of 1996.

<sup>160</sup> [1967] 2 AC 1347.

<sup>161</sup> The Canadian Supreme Court in *Peso Silver Mines Ltd (NPL) v Cropper* [1966] 58 DLR 1 (2d) absolved a director from liability on the basis that they had acted in good faith in purchasing mining claims, which his company had declined to purchase due to its poor financial position. For a detailed analysis on the different approaches adopted by the English and Canadian courts see Prentice, “Regal Hasting Ltd v Gulliver-The Canadian Experience” (1967) 30 MLR 450 at 451; Beck, *The Saga of Peso Silver Mines*, (1971) 49 Can B Rev 80; 100-2 DD.

<sup>162</sup> [1967] 2 AC 1347.

<sup>163</sup> *Regal Hasting Ltd v Gulliver* [1967] 2 AC 1347.

Although these rules are useful in terms of providing stringent conditions that protect the company, the effects of the rules can be avoided if a director makes a disclosure of his interests to the company in a board meeting.<sup>164</sup> If a director makes disclosure before engaging in a transaction, a company can decide whether to forgo the opportunity. However, the rejection of an opportunity does not entitle a director to utilise the opportunity to his own advantage, as “that might impose too great a strain on their impartiality.”<sup>165</sup> A director may, therefore, be liable for pursuing an opportunity which has been rejected by a company even if he discloses his interests to the board and refrains from attending and voting,<sup>166</sup> unless the company has authorised the act of a director in a general meeting or under the articles of the company. However, in some instances, a board of directors may permit a director to get involved in an opportunity which it has rejected, provided the board takes a bona fide decision to reject an opportunity.<sup>167</sup>

To curb the abuse of the opportunities of companies, the UK's Jenkins Committee required directors not to “make use of any money or other property of the company or any information acquired by virtue of his position as a director or officer of the company to gain directly or indirectly an improper advantage for himself at the expense of the company”.<sup>168</sup> The Final Report of the Company Law Review Group also recommended that a director should not use the company's property information, or opportunity, unless such use is authorised by an ordinary resolution or, where the constitution permits, the board of a company.<sup>169</sup>

Companies legislation in British Columbia<sup>170</sup> has a similar provision which states that where a director or officer holds any office or possesses any property which might give rise, directly or indirectly to conflicts with his duties to the corporation, he must disclose the fact and the nature of character and extent of such conflict.

---

<sup>164</sup> Ibid.

<sup>165</sup> PL Davies, op cit n 14, p 594.

<sup>166</sup> *Benson v Heathorn* (1842) 1 Y & CCC 326, Per Knight-Bruce V-C at 341-342.

<sup>167</sup> The board's decision to reject the opportunity must have been taken bona fide in the interests of the company and not in the interest of the director. See *Queensland Mines Ltd v Hudson* (1978) 52 ALJR 379, PC.

<sup>168</sup> Report of the Company Law Committee, Cmnd 1749, Para 99 (1962).

<sup>169</sup> The Company Law Review Steering Group: Final Report, (DTI, 2001), Clause 308.

<sup>170</sup> British Columbia Companies Act, ss 146, 160.



The Ghanaian Companies Code obliges a director not to "use for his own advantage any money or property of the company or any confidential information or special knowledge obtained by him in his capacity of director."<sup>171</sup>

The use of the term 'confidential information', appears to be inappropriate because what matters is not the confidentiality of information, but the use to which a director puts it.<sup>172</sup> As such, inappropriate use of any information obtained in the course of directorship can be a basis for liability. However, the Ghanaian code makes an appropriate distinction between information, opportunity and company assets. It, therefore, avoids the confusing interpretation of 'information' as property that was advanced in *Phipps v Boardman*.<sup>173</sup> In that case, Lord Denning held that a director would be accountable if he benefits himself from information or knowledge "which he has been employed by his principal to collect or discover, or which he has otherwise acquired, for the use of his principal for such information or knowledge is the property of his principal." On the other hand, Lord Upjohn took a contrary view<sup>174</sup> in his dissenting opinion, and stipulated that information is not property at all so long as the knowledge acquired was incapable of being used for a director's benefit to injure the trust.<sup>175</sup> The Ghanaian Code avoids this ambiguity by recognising improper use of both property and information as a basis for liability.

### **3.4.2 Competing with the company**

Despite the operation of the no conflict rule in Kenya, directors are able to compete with their companies by holding several<sup>176</sup> directorships.<sup>177</sup>

Although it may appear undesirable to allow directors to hold multiple directorships, the Act enables companies to weigh the practicability of having a director who has other directorships by requiring particulars of all directorships to be contained in the

---

<sup>171</sup> Act 179.

<sup>172</sup> Beck, *The Saga of Peso Silver Mines*, (1971) 49 Can B Rev 80.

<sup>173</sup> [1965] Ch 992 (CA).

<sup>174</sup> Professor Beck was also of the opinion that the important question is not whether the information acquired by the agent is the property of the trust, but whether the agent used his position to make a profit without the informed consent of his principal. See SM Beck, *The Saga of Peso Silver Mines*, (1971) 49 Can B Rev 80.

<sup>175</sup> [1967] AC 46, 127-129, per Lord Upjohn.

<sup>176</sup> *London & Mashonaland Exploration Co. v New Mashonaland Exploration Co* [1891] WN 165.

<sup>177</sup> Multiple directorships are recognised by both the Companies Act and Table A, article 78.

register of directors and secretaries.<sup>178</sup> As such, companies can, if they wish, use non-executive directors as “a good source<sup>179</sup> for non-executive talent.”<sup>180</sup> Although the rule against profiting<sup>181</sup> prevents abuse of multiple directorships by requiring directors to obtain “approval of all the companies within whose line of business the opportunity in question fell,”<sup>182</sup> limiting the number of directorships that a director may hold might reduce the chances of competition with the company. It is also necessary to require a director to obtain consent from his company before he can hold more than two directorships and prohibiting executive directors from becoming non-executives of any competing companies.

### 3.4.3 *Contracts with the company*

As a fiduciary, a director must not contract with his company without the approval of the board of directors.<sup>183</sup> The principle applies both to transactions directly connected with the director and those in which they are interested in any way. It is a rule meant to protect the company and cannot, therefore, be used to protect a director against a third party.<sup>184</sup>

In *Leisure Lodges Limited v Yashvin A Shretta*,<sup>185</sup> one of the grounds relied upon by the Court of Appeal in granting an interim liquidation order was the failure on the part of directors to disclose their interests when they supplied the hotel and club with TV sets and safes.

---

<sup>178</sup> Section 201, the Act.

<sup>179</sup> Both the Greenbury's Report (Directors Remuneration: Report of a Study Group chaired by Sir Richard Greenbury, 1995) and Cadbury Committee (Report of the Committee on the Financial Aspects of Corporate Governance, 1992) underscore the supervisory role of the non-executive directors.

<sup>180</sup> Davies PL, op cit n 14, p 623.

<sup>181</sup> It is not wrong to have competing directorship if there is no possibility of conflict. See Boros, "The Duties of Nominee and Multiple Directors Part 11" (1990) 11 Co Law 6.

<sup>182</sup> PL Davies, op cit n 14, p 608.

<sup>183</sup> Section 200 (1), The Act. Unlike section 320 of the British Companies Act 1985, the Act does not have a provision prohibiting a company from entering into substantial property transactions with a director. Under section 320 of the British Companies Act, a company is prohibited from entering into an arrangement whereby a director acquires an asset worth £100,000 or 10% of a company's assets.

<sup>184</sup> *Transvaal Lands Co v New Belgium (Transvaal) Land and Development Co* [1914] 2 Ch 488, (CA) The same principle applies to promoters.

<sup>185</sup> Civil Appeal No 10 of 1997 in Winding Up Cause No 23 of 1996 (Court of Appeal, Kenya).

Although the failure to disclose such interests entitles a company to avoid the contract,<sup>186</sup> it does not entitle the other party to enforce it against the company. Provided that a director has contracted with the company without due disclosure, a company is entitled to avoid the contract, even in instances where it would have benefited from it,<sup>187</sup> or ratify the same. This is because the director is in breach of general duty of directors not to make a profit out of his position.<sup>188</sup>

A director, including one who is holding a major shareholding, interested in a contract is not precluded by equity from voting in a meeting where his interest and the contract are being discussed.<sup>189</sup> Although the minority would be able to bring an action, should the votes be misused to defraud them, directors still have unfettered freedom in the absence of fraud.

The Act, however, counters the undesirable effects that would result from the exercise of the aforesaid unfettered freedom by requiring further disclosure to the board of directors.<sup>190</sup> Where a director becomes interested after the contract has been made, the declaration is required to be made at the first meeting of directors held after the director became interested.<sup>191</sup> A director who fails to comply with this requirement is liable to a fine not exceeding two thousand Kenyan shillings.<sup>192</sup> Although the requirement to make disclosure when the contract or proposed contract is brought before the board ensures that no contract is made without the knowledge of the board, it becomes ineffective when contracts are not brought before the board in practice. In addition, disclosure to the board offers inadequate protection to shareholders when directors take a lenient stand towards a fellow director, especially if they are likely to disclose their own interests in the future.<sup>193</sup>

---

<sup>186</sup> *Aberdeen Rly v Blaikie* (1854) 10 Macq HL 461.

<sup>187</sup> *Ibid.*

<sup>188</sup> *Regal Hasting Ltd v Gulliver* [1967] 2 AC 1347.

<sup>189</sup> *North West Transportation v Beatty* [1887] 12 App Cas 589.

<sup>190</sup> Sections 200 (1), (2) requires a director who is in anyway interested in a contract or proposed contract with the company to declare the nature of his interest at a meeting of the directors of the company.

<sup>191</sup> Section 200 (2), The Act.

<sup>192</sup> Section 200 (4), The Act.

<sup>193</sup> It was held in *Neptune (Vehicle Washing Equipment) Ltd v Fitzgerald* [1996] Ch 274 that a single director could constitute a meeting for the purposes of Section 317. The Section imposes a duty on a director, who is in any way interested in a contract to declare the nature of his interest at a meeting of directors.

Whilst article 84(3)<sup>194</sup> suggests that directors who make their disclosures to the board<sup>195</sup> are excluded from liability where they receive profits, contrary to section 200 of the Act, this ambiguity is countered by section 206 of the Act which provides that:

"[A]ny provision contained in articles of a company or in any contract with a company or otherwise, for exempting any officer of the company...from...any liability which by virtue of any rule of law would otherwise attach to him in respect of any negligence, default, breach of duty or breach of trust of which he may be guilty in relation to the company shall be void."

Although section 206 of the Act might appear to have the effect of invalidating any provision contained in the articles which has the effect of exempting a director from liability, it can be argued that articles exempting directors from liability arising from conflict of interests situations are valid because the breach of the conflict of interest rule does not necessarily result in a breach of duty. This view was favoured by Vinelott J in *Movitex Ltd v Bulfield and Ors*<sup>196</sup> where he took the view that it is possible for an article to relax the conflict of interest rule and still comply with section 310.<sup>197</sup> Thus, whilst liability arising from a breach of the conflict of interests rule may be exempted by disclosure to the board, it is not possible to exempt a director from liability arising from a breach of duty.

Due to the ambiguity relating to the effect of article 84 (3) on section 200 (1) of the Act, the articles needs to be amended in order to prohibit directors from entering into conflicts of interest situations or to permit them only in clearly regulated situations.

---

<sup>194</sup> Table A. The equivalent of article 85 of the 1985 British Act.

<sup>195</sup> Section 317 of the British Companies Act 1985 was enacted to ensure that articles did not dispense with disclosure to the board altogether. The section makes disclosure to the board a minimum duty.

<sup>196</sup> [1986] 2 BCC 99, 403.

<sup>197</sup> British Companies Act 1985. See S Griffin, op cit n 1, p 259.

### 3.4.4 Bribery and Gifts and other secret benefits

Common law prohibits a director from accepting a bribe, a gift, a commission, or a share in the profit of a third party to any transaction.<sup>198</sup> Where a director breaches this duty, the benefit accrued is recoverable from him or the third party who may be in possession of the benefit.<sup>199</sup> The company can also sue the director and the third party jointly and severally for damages sustained.<sup>200</sup>

A director may keep his personal profit where members in general meeting ratify it.<sup>201</sup> However, he cannot keep the profit if the directors were in the majority and used their powers to pass the resolution.<sup>202</sup>

Although a company can recover profits received after retirement, provided the director had breached his fiduciary duties,<sup>203</sup> the company has little hope of recovering profits obtained by a director when the director leaves office prior to contracting with a third party.<sup>204</sup>

### 3.4.5 International Regulatory Framework

While changes in the Kenyan law and institutional reforms of the judiciary and civil service may help alleviate corrupt practices associated with fiduciaries, the changes would not have full impact without the international community implementing the OECD Convention on Combating the Bribery of Foreign Public Officials in International Business Transactions.<sup>205</sup> Due to the increase of corruption in the post Cold War period as a result of the scramble for new markets, industrialised countries

---

<sup>198</sup> *Phipps v Boardman* [1967] 2 AC 46, 123 per Lord Upjohn.

<sup>199</sup> *Grant v Gold Exploration & Development* [1900] 1 QB 233.

<sup>200</sup> *Salford Corporation v Lever* [1891] 1 QB 168; *Phipps v Boardman* [1966] 3 All ER 721.

<sup>201</sup> *Re Gee & Co (Woolwich) Ltd* [1972] 2 WLR 515.

<sup>202</sup> Loose et al, *The Company Director Power and Duties*, (7<sup>th</sup> Edition, Jordans, 1993) p 185; *Cook v Deeks* [1916] 1 AC 554.

<sup>203</sup> *Industrial Development Consultants Ltd v Cooley* [1972] 2 All ER 162.

<sup>204</sup> *Island Export Finance Ltd v Umunna* [1986] BCLC 460. A director may be liable if his resignation was made in order to acquire for himself the opportunity sought by the company, or where his position, rather than fresh initiative, led to the opportunity. See *Canadian Aero Service Ltd v O'Malley* [1974] 40 DLR per Lord Laskin J.

<sup>205</sup> The Convention was passed on November 21, 1997 in the Organisation of Economic Co-operation and Development (OECD). Since the convention cannot pass laws directly, the Convention only works through committing member states to pass legislation outlawing bribery of foreign public officials. United States criminalised transnational bribery in the Foreign Corrupt Practices Act in 1977. It has also enacted the Organisation of American States' Convention Against Corruption. See Gantz, "Globalizing Sanctions Against Foreign Bribery: The Emergence of a New International Legal Consensus", 18 *Northwestern Journal of International Law & Business* 282 (1997). Cited in Kimberly, op cit n 136, at 530.

have increasingly allowed their multinational companies to engage in corrupt practices. In some countries, such as Germany and Belgium, bribes<sup>206</sup> have been tax deductible. Sometimes, companies that are under strict regulations have lost out on competitive businesses abroad.<sup>207</sup>

The Convention remains unenforceable in countries that have not incorporated it into their domestic legislation.<sup>208</sup> In general, a vast majority of foreign governments have been reluctant to legislate against bribery of foreign public officials. The German Chamber of Commerce once observed that:

"It is not the duty of the German lawmaker to ensure the rectitude of officialdom in foreign countries. Corruption is not a legal problem but a cultural one. In certain countries presents and payments are tolerated as privileges by the state." <sup>209</sup>

The Convention does not outlaw facilitative payments that are made to bureaucrats to speed up existing processes. Instead, national governments are expected to legislate on such issues.<sup>210</sup> Given that gifts, intentional offers or promises can amount to bribery under the Convention, it can be argued that facilitative payments are no different from gifts.<sup>211</sup>

---

<sup>206</sup> OECD Convention defines the offence of bribery as, "any intentional offer, promise or gift bestowing any undue pecuniary or other advantage, whether directly or through an intermediary to a foreign public official, for that official or for a third party in order that the official act or refrain from acting in relation to the performance of official duties in order to obtain or retain business or other improper advantage in the conduct of international business." See Low L, "The International Anti-corruption Standards of the OECD and OAS: A Comparison with the U.S. Foreign Corrupt Practices Act." Cited in Moran, op cit n 124, at 143.

<sup>207</sup> Between 1994 and 1995 the US lost \$ 36 billion of business deals due to bribery and corruption by its competitors. See Graf Lambsdorf J 1998, "An empirical investigation of bribery in international trade" in M Robinson (ed), *Corruption and Development*, (London: Franl Cass). Cited in Moran, op cit n 124, at 142.

<sup>208</sup> "The provisions of a treaty entered into by the Government...do not become part of the municipal law...save in so far as they are made such by laws of that country. See *East African Community v R* [1970] EA 457.

<sup>209</sup> Moran, op cit n 124, at 147.

<sup>210</sup> Low, "The International Anti-corruption Standards of the OECD and OAS: A Comparison with the U.S. Foreign Corrupt Practices Act." Cited in Moran, op cit n 124, at 143

<sup>211</sup> Ibid.

The Convention also fails to restrict the value of gifts given to foreign officials.<sup>212</sup> This displays a great variation from the standards set for multinationals in their home countries. In the U.S.A., for instance, some regulations prohibit private individuals or companies from giving gifts of more than \$ 50.<sup>213</sup> Failure of the Convention to have similar requirements reflects negatively on its effectiveness in the fight against corruption.

Despite these shortcomings, some measures adopted by the Convention would reinforce the accountability of directors. For instance, obligation is imposed on signatories to ensure the "prohibition of 'off the books' accounts, inadequately identified transactions, the recording of non-existent expenditures, the entry of liabilities with incorrect identification of their object, and the use of false documents to either pay or conceal bribes."<sup>214</sup> Moreover, auditors are required to "report infringements to the regulatory authorities."<sup>215</sup> As a result, companies have to "examine their existing audit and review procedures, including due diligence procedures relating to the financial and ethical screening and monitoring of agents, other representatives and/or consultants employed by a company in a foreign country."<sup>216</sup>

Although the OECD Convention requires states to implement high business ethics and standards,<sup>217</sup> States with weak economies are unlikely to implement strict standards, as they are likely to be considered hostile towards strong foreign investors. As such, the only solution to the problem is for a Convention to impose uniform universal conditions requiring multinational corporations to uphold high business ethics. In addition, the recognition of multinationals, under international

---

<sup>212</sup> According to the OECD Convention, "a foreign public official means any person holding a legislative, administrative or judicial office, of a foreign country whether appointed or elected; any person exercising a public function for a foreign country, including for a public agency or public enterprise; and any official or agent of a public international organisation." See OECD 1997 in Moran, *ibid*, at 143.

<sup>213</sup> *Ibid*.

<sup>214</sup> Cockroft, "Can Accountants cope with off-shore Bribery?" [1998] Dec Accountancy, 78. Cited in Moran, *ibid*, at 146.

<sup>215</sup> Control Risks Group, "Corruption and Integrity: Best Business Practice in an Imperfect World", [1998] Control Risks Group. Cited in Moran, *ibid*, at 146.

<sup>216</sup> Moran, *ibid*.

<sup>217</sup> Article 3 (2) provides that in the event that, under the legal system of a Party, criminal responsibility is not applicable to legal persons, that Party shall ensure that legal persons shall be

law, as subjects with obligations towards good governance, environment, and society would enable multinationals to be held to account for their misconduct.

Making Kenya's legislation effective might also help to reduce corrupt practices because some foreign companies only engage in corrupt practices where the law is lax. For instance, although British Petroleum (BP) requires its group of companies outside the UK not to accept gifts or entertainment during a competitive bid or tender exercise, it requires its regional directors and country managers to “put in place local rules to cover the giving and acceptance of gifts and entertainment, which reflect expectation and local custom”.<sup>218</sup>

Thus, there is an urgent need for Kenya to tackle regulatory grounds that breed breach of fiduciary duties. Given that a vast majority of multinational companies are already subjected to stringent conditions in their home countries, the enforcement of similar requirements should be possible.

### 3.5 Conclusions

Although shareholders may sometimes benefit when directors ignore the interests of corporate stakeholders, they also stand to incur long-term losses when the reputation of a company suffers. Thus, honouring community interests might be in the best interests of a company. This is because such responsibilities nurture good customer relations, motivate employees, and contribute to the well being of the national economy. Since the Act does not specify in whose interests directors are supposed to act and to whom they owe their duties, there is a need for the Act to define expressly the term "company as a whole" to mean the interests of all shareholders or other requisite interest groups, such as employees, creditors, and the society within which the company operates. Effecting such changes would enable directors to ascertain their obligations easily.

---

subject to effective, proportionate and dissuasive non-criminal sanctions, including monetary sanctions, for bribery of foreign public officials.

<sup>218</sup> BP, *What We Stand For: Our Business Policies*, (London: BP, 1998). Cited in Moran, op cit n 124, at 147.



To raise the status of employees, it is submitted that companies can give the employee<sup>219</sup> full voting rights within the company. This can be achieved by allowing employees to nominate representative directors to the board.<sup>220</sup> Giving employees voting rights would overcome the enforcement problems encountered in some countries, such as the UK, where the general duty to consider the interests of employees is owed by directors to the company. At the moment it would appear that employees have no *locus standi* to sue as employees. Although they could sue if they were shareholders, they would still have to obtain a majority to do so.<sup>221</sup>

The duty of directors to act in the best interests of the company and for a proper purpose, should be expanded to include matters that are not only related to the company, but other incidental matters, such as corruption, that are a danger to the society. This would, in turn, promote corporate citizenship, as companies would have regard for national sovereignty, health, environment, and other incidental matters.

Although the honouring of some social responsibilities by directors may benefit the company in the long-term, some actions, such as the giving of donations, ought to be closely regulated because they are prone to abuse by corrupt directors. Abuse of donations can, for instance, be controlled by limiting the amount that can be given by directors or requiring prior consent of shareholders before the donations are given. Corrupt practices by directors can also be reduced by having *strict rules* that would discourage directors from entering into conflicts of interest situations. Such rules should, for instance, seek to reduce the number of directorships a director may hold and require directors to disclose their interests to the General Meeting rather than merely to the board of directors.

Although making changes in the Act might well discourage breach of duties by directors, there is also a responsibility on the international community to regulate multinational corporations effectively. This is because reliance on Kenya's

---

<sup>219</sup> The term employee should be clearly defined to mean those with a contract for service. Failure to do so, may lead to misleading interpretation that would imply independent contractors, such as consultants. Boyle, op cit n 123, at 285.

<sup>220</sup> Vagts, "Reforming the 'modern' Corporation: Perspectives from the German", (1966) 80 *Harvard Law Review* 23. EC Steelfel and B Von Falkenhausen, "The New German Stock Corporation Law", (1967) 52 *Cornell Law Quarterly*, 518, 537. Cited in PA Thomas, op cit n 78, p 30.

<sup>221</sup> Boyle, op cit n 123, at 285.

legislation to curb abuse of power by multinational corporations and corruption may not be sufficient given that the economic power of multinational corporations enable them to disregard principles of good corporate citizenship.

## CHAPTER FOUR

### 4.0 THE CONDUCT OF DIRECTORS: DUTY OF SKILL AND CARE

#### 4.1 Introduction

As the countries and economies of the world become more integrated and interdependent due to globalisation and competition, high standards of conducting business<sup>1</sup> are increasingly demanding more input from company directors. As such, the steps adopted by individual governments to regulate business determine whether the global system is harmful to the economy of a country. For a country to draw economic benefits from the global system, the legal regulatory framework has to conform to international commercial standards.<sup>2</sup> It is therefore imperative for any government “to create conditions in which people can take advantage of the opportunities and challenges of globalisation.”<sup>3</sup> A conducive environment attracts both foreign and local investors,<sup>4</sup> since investments can hardly be made “where there are no prospects for reasonable return in a stable and predictable environment.”<sup>5</sup>

Realisation of the benefits accrued from the global system has prompted major key players in the economy of Kenya to create new partnerships<sup>6</sup> across the world.

---

<sup>1</sup> The attempt by Shell to dispose of the redundant Brent Spar oil in Mid -Atlantic was met with pressure from the media and from consumers, who actually begun to boycott its products. Eventually, Shell was compelled to dispose of the structure in a way that was much more expensive than its original proposals. See Bamford, “Directors’ Duties: The Public Dimension”, [2000] 2 Co Law 38.

<sup>2</sup> A comparison of Kenya and Malaysia provides a good illustration of the effect that response to global economy can have on a country. In spite of the two countries obtaining independence in 1963 with roughly the same per capita income, Malaysia has become one of the Asian Tiger economies due to implementation of policies while the living standard in Kenya has hardly changed since independence. See J James, “Connecting to the Global Economy Through the World Trading System” [2000] Sep-Dec *Professional Management Journal of the Institute of Certified Public Secretaries of Kenya*, at 10. Mr Jeffrey James is a former British High Commissioner to Kenya.

<sup>3</sup> Ibid at 24.

<sup>4</sup> Foreign investments bring in capital, new technology, quality products and also make a strong contribution to growth, implementations, exports, and government revenue. Similarly, domestic investment helps in mobilising Kenya’s own internal resources. See Ibid at 25.

<sup>5</sup> Ibid, at 25.

<sup>6</sup> Factors that favour mergers and strategic alliances include: growth in market economies, the liberalisation or deregulation of matters such as exchange control interest rates, privatisation, and de-monopolisation. The said factors are often triggered by falling trade barriers caused by regional

Illustrative of such integration is the partnership of Kenya Airways and KLM. The partnership has not only boosted the workforce of the company in order to meet the expanding business, but it has made significant contributions to the Kenyan Exchequer, instead of operating at a loss as in the days when Kenya Airways was a parastatal.<sup>7</sup>

In spite of the benefits accruing from globalisation, the integration and diverse geographical locations of companies erode the decision-making power of shareholders. Directors also find it difficult to keep track of the affairs of a company that conducts its business in a variety of geographical locations.

It is against this background of the changing business environment that this Chapter aims to assess whether the standards of care, skill, and diligence expected from directors in Kenya meet the developing and rising business standards of the global economy.

## **4.2 The Nature of the Duty of Skill and Care**

### **4.2.1 Liability of Directors for Negligence**

Apart from the fiduciary duties owed by directors to a company, they also owe to their companies a duty of care and skill<sup>8</sup> at common law.<sup>9</sup> Negligence in the performance of duties attaches liability to a director.<sup>10</sup> Any damages occasioned to

---

integration policies, the influence of WTO, single currencies, corporate restructuring and globalisation. See Kamau, "Building Partnerships for Business Success" [2000] Sep-Dec *Professional Management Journal of the Institute of Certified Public Secretaries of Kenya*, at 10.

<sup>7</sup>Ibid.

<sup>8</sup> Skill has been defined as "that special competence which is not part of the ordinary equipment of the reasonable man but the result of aptitude developed by special training and experience which requires those who undertake work calling for special skill not only to exercise reasonable care but measure up to the standards of proficiency that can be expected from persons undertaking such work." See *Daniels v Anderson* (1995) 37 NSWLR 438, at 500 Per Clarke and Sheller JJA.

<sup>9</sup> Directors owe the company a duty of care both at common law (legal duties) and equity (equitable duty). Per Lindley MR in *Lagunas Nitrate Company v Lagunas Syndicate* [1899] 2 Ch 392 at 435.

<sup>10</sup> Negligence needs to be gross or culpable for it to attach any liability to a director. For the distinction between gross and mere negligence see *Re Brazilian Rubber Plantations and Estates Ltd* [1911] 1 Ch 425, *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407; *Wilson v Brett* (1843) 11 M & W 113; *Turquand v Marshall* (1869) 4 Ch App 376; *Overend, Gurney & Co v Gibb* (1872) LR 5 HL 480

(HL); *Re National Bank of Wales Ltd* [1899] 2 Ch 629 at 671 (CA); and *Re Brazilian Rubber Plantations and Estates Ltd* [1911] 1 Ch 425.

the company by a negligent act are recoverable by the company.<sup>11</sup> The duty of care owed by a director to a company emanates from the assumption of responsibility for the property or affairs of the company.<sup>12</sup> The Kenyan Companies Act<sup>13</sup> (the "Act") prohibits the exemption of directors from liability which would attach to them in respect of any negligence or breach of duty.<sup>14</sup>

#### **4.2.2 Origins of the Duty**

The duty to exercise skill, care, and diligence arises from fiduciary obligations, contractual obligations,<sup>15</sup> *Donoghue v Stevenson*<sup>16</sup> principles, or statutes. The duties arising from fiduciary relationship (equitable) and common law (legal) are occasionally intertwined. Illustrative of their distinction is the Australian case of *Permanent Building Society v Wheeler*<sup>17</sup> where the court considered whether a director of a building society owed fiduciary duties to it to exercise a reasonable degree of care and diligence. While the counsel for the Building Society sought to characterise the claim as a breach of fiduciary duty and alternatively a claim in negligence, Ipp J saw much merit in the argument that directors owe duties to exercise care and skill at law.<sup>18</sup>

#### **4.3 The Standard of Skill and Care Required in Kenya**

To determine whether a director is in breach of the duty of skill and care, the Kenyan courts follow the rules laid down by Mr PJS Hewett, Commissioner of Assize<sup>19</sup> in *Flagship Carriers Ltd v Imperial Bank Ltd*.<sup>20</sup> As discussed in Chapter Three, Mr PJS Hewett found the directors liable for breach of fiduciary duties and also laid down the rules governing their duty of skill, care, and diligence as follows:

---

<sup>11</sup> *Dorchester Finance Co Ltd v Stebbing* [1989] BCLC 49. Directors who had left all their duties to a fellow director were held liable for negligence when the active director issued unenforceable loans.

<sup>12</sup> Per Lord Browne-Wilkinson in *Henderson v Merret Syndicates Ltd* [1995] 2 AC 145 at 205.

<sup>13</sup> Cap 486, Laws of Kenya.

<sup>14</sup> Section 206.

<sup>15</sup> *Lister v Lamford Ice and Cold Storage Co Ltd* [1957] AC 555.

<sup>16</sup> [1932] AC 562.

<sup>17</sup> (1993-1994) 11WAR 187, 235.

<sup>18</sup> *Permanent Building Society v Wheeler* (1993-1994) 11WAR 187, 235. Although it was concluded that the director owed the building society a duty in law and equity to exercise reasonable care and skill, the equitable duty was recognised to be distinct from a fiduciary duty (p 239).

<sup>19</sup> A Commissioner of Assize is a part time judge.

<sup>20</sup> High Court Civil Case No 1643 of 1999 (Unreported), Ruling per PJS Hewett.

- They must exercise the degree of skill which may reasonably be expected from a person of their knowledge and experience, but they are not liable for errors of judgement.
- They are not bound to give continuous attention to the company's affairs.
- In case of duties properly left to an official of the company they are, in absence of grounds for suspicion, justified in trusting that official to perform his duties honestly.
- Apart from the general duties summarised above, their duties depend on the nature of the company's business and the manner in which the work is distributed between the directors and the other officials of the company, provided that the distribution is reasonable and not inconsistent with the provisions of the articles.<sup>21</sup>

Given that a director is only required to exhibit a degree of skill and care that may reasonably be expected from a person of his knowledge and experience, the courts apply a subjective test to assess the liability of directors for breach of the duty of skill and care. In doing so, the courts must consider the knowledge, skills and experience<sup>22</sup> of a director.<sup>23</sup>

The application of subjective standards presupposes that a director cannot be held liable for "honest mistakes" of judgment.<sup>24</sup> It is true to say that subjective standards to exercise skill and care are "remarkably low" and "light"<sup>25</sup> because a director would, for instance, not be found liable in negligence for being in total ignorance of the business of the company.<sup>26</sup> It is notable that there are no statutory provisions in Kenya requiring directors of a company to have expertise and experience in the

---

<sup>21</sup> Ibid, at 11. Mr Hewett relied on the rules as laid down in Charlesworth & Morse, *Company Law*, (9<sup>th</sup> edition, Sweet & Maxwell, 1968), 277. The rules were originally formulated by Romer J in *Re City Equitable Fire Insurance Co* (1925) Ch 407.

<sup>22</sup> The courts often take into consideration the part time nature of most directorships and the lack of special skills by directors. See *Turquand v Marshall* (1869) 4 Ch App 376.

<sup>23</sup> Professor Gower, however, argues that the test laid down by Romer J in *Re City Equitable Fire Insurance Co Ltd* is partly objective and subjective. See LCB Gower, *Gower's Principles of Modern Company Law* (5th ed, Sweet & Maxwell London, 1992) p 551.

<sup>24</sup> *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407 at pp 429 (Per Romer J). Sealy also observes that a pure objective test cannot be applied with respect to directors' duties of care and skill since the subjective test is necessary and cannot be ignored. See Sealy, "Reforming the Law on Company Directors' Duties" [1991] 12 Co Law 175.

<sup>25</sup> Op cit n 23.

<sup>26</sup> *Re Brazilian Rubber Plantations and Estates Ltd* [1911] 1 Ch 425.

management of its business.<sup>27</sup> As such, the application of subjective standards implies that there is no minimum reasonable amount of skill required from directors. In fact, the results of the survey conducted in Nairobi between October 2001 and January 2002, indicated that directors do not take their duty of skill, care, and diligence seriously (54 percent of respondents took that view).<sup>28</sup>

The low standards<sup>29</sup> of care and diligence required from directors in Kenya can be traced back to the traditional reluctance of the English judiciary to treat differently directors who were part time officers and figureheads devoid of any particular executive skills and executive directors. The English courts felt that imposing onerous standards of care and skill on them would be unreasonable.<sup>30</sup> The courts were also reluctant to “interfere with the internal management of companies acting within their powers”<sup>31</sup> because they sought to have shareholders who appointed amateur directors bear the consequent risks.<sup>32</sup> This view clearly ignored the negative impact of directorial misconduct on creditors, employees, and society.<sup>33</sup>

Due to public expectations and exigencies of today’s business, the courts in some jurisdictions have continuously changed their attitude towards the low subjective standards set in earlier cases.<sup>34</sup> As a result, they have sought to raise the standards by suggesting that the relevant test of the duties of a director involves not only a subjective element but also an objective one which requires a director to possess the skill that “may reasonably be expected from a person undertaking those duties”.<sup>35</sup>

---

<sup>27</sup> Although it is a requirement under the London Stock Exchange, Listing Rules, paras 3.8, there is no reasonable standard of general management. Directors are not under a duty to deliver services with reasonable care and skill because they are exempted from s 13 of Supply of Goods and Services Act 1982.

<sup>28</sup> The results of the survey are analysed in detail in Chapter 9.

<sup>29</sup> In *Daniels and Others v Anderson and Others* (AWA case) (1995) 16 ACSR 607, 658 the New South Wales Court of Appeal observed that old cases which imposed the subjective tests and the need for gross negligence were outdated. The subjective duty of care, skill, and diligence expected from a director was described as remarkably low.

<sup>30</sup> JH Farrar et al, *Farrar's Company Law* 3rd ed, (London: Butterworths, 1991), p 396.

<sup>31</sup> *Burland v Earle* [1902] AC 83, 93 per Lord Davey. In *Pavlides v Jensen* [1956] Ch 565 the court declined to intervene in a sale of company assets at an undervalued price. Also see *Charitable Corporation v Sutton* (1742) 2 Atk 400, per Lord Hardwicke.

<sup>32</sup> Per Lord Hatherly in *Turquand v Marshall* (1869) 4 Ch App 376 at 386.

<sup>33</sup> Op cit n 30.

<sup>34</sup> The courts are adopting a more interventionist approach to the internal management of companies. See Editorial comment, “Directors-True or False?” (1997) 18 Co Law 129 at 129.

<sup>35</sup> *Norman v Theodore Goddard* [1991] BCLC 1028. Hoffmann J observed that “a director who undertakes the management of the company’s properties is expected to have reasonable skill in

For instance, the Nigerian Law Reform Commission<sup>36</sup> sought to raise the low standards set by *Re City Equitable Fire Insurance Co*<sup>37</sup> by requiring directors to conform to a professional standard of care, just as doctors or lawyers must. This approach followed the objective standard adopted by the Lawrence Committee (Ontario) in 1967, which provides that:

"Every director of a company shall exercise the powers and discharge the duties of his office honestly, in good faith and in the best interests of the company, and in connection therewith, shall exercise that degree of care, diligence and skill which a reasonably prudent director would exercise in comparable circumstances." <sup>38</sup>

#### **4.3.1 Standard of Skill and Care required in the UK**

The present English case law suggests that the relevant test for the duties of a director involves an objective element. A director is therefore required to possess the skill that "may reasonably be expected from a person undertaking those duties".<sup>39</sup> For instance, in *Re D'Jan of London Ltd*,<sup>40</sup> Hoffmann J equated the objective standard set by section 214 (4)<sup>41</sup> of the Insolvency Act 1986<sup>42</sup> with the common law duty of care owed by present day directors.

---

property, but not in off shore tax avoidance." See Hicks, "Directors' Liability For Management Errors", (1994) 110 LQR 390, at 390.

<sup>36</sup> Nigeria Law Reform Commission, *Working Papers on the Reform of Nigerian Company Law*: Volume 1- Review and Recommendations, 1987 p 219.

<sup>37</sup> (1925) Ch 407.

<sup>38</sup> Ibid.

<sup>39</sup> Hicks, op cit n 35, at 390.

<sup>40</sup> [1993] BCC 646.

<sup>41</sup> The section sets out the requirements for wrongful trading as (a) that the company has gone insolvent liquidation; (b) that at some time before the commencement of the winding-up the person concerned knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation; and (c) that the person concerned was a director or shadow director of the company at that time.

<sup>42</sup> The wrongful trading provision introduces an objective element in assessing directors' liability once the company has entered insolvency by requiring a reasonably diligent person having both (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by that director in relation to the company, and (b) the general knowledge, skill, and experience that that director has.



Similarly, in *Dorchester Finance Co Ltd v Stebbing*<sup>43</sup> a non-executive director failed to attend any board meetings and sought to justify his inactivity by alleging that non-executive directors could allow an executive director to have absolute control, and they could also rely on auditors to do a proper job. Foster J rejected this argument and held that under the Companies Act the duties of executive and non-executive directors were the same, where both have similar experiences.<sup>44</sup> The court considered that they failed to perform their duties and to exhibit the necessary skill and care.<sup>45</sup>

It is notable that despite the attempts by the English Judiciary to raise the standard of skill and care, there is still no existing statutory duty reflecting the judicial attitude. The final report of the Company Law Review Steering group has recommended that a director ought to exercise the care, skill, and diligence reasonable to be expected of a director in his position and with any additional knowledge and experience which he actually has.<sup>46</sup>

In the UK, stringent standards of care, skill and diligence exist in relation to wrongful trading. The Insolvency Act 1986 requires the conduct of a director to be assessed against that of a reasonably diligent person with the general knowledge, skill and experience that director has.<sup>47</sup> Company Directors Disqualification Act 1986 (UK) also imposes similar stringent standards.<sup>48</sup> English courts have

---

<sup>43</sup> [1989] BCLC 498.

<sup>44</sup> The executive and non-executive directors had relevant accountancy experience.

<sup>45</sup> Per Foster J in *Dorchester Finance Co Ltd v Stebbing* [1989] BCLC 498, 505.

<sup>46</sup> The Company Law Review Steering Group: Final Report, (DTI, 2001), Clause 306.

<sup>47</sup> Section 214. Also see comment in D Prentice, "Creditors' Interests and Directors' Duties" (1990) 10 OJLS 265.

<sup>48</sup> In *Re Continental Assurance Co of London Plc* [1996] BCC 888 a senior bank official who was a non-executive director of the subsidiary company and its parent company was disqualified. The wholly owned subsidiary had made a number of cash advances to the parent company which were contrary to provisions relating to prohibitions on financial assistance towards the purchase of shares. After collapse of both companies, the Secretary of State obtained an order disqualifying the director. Although the director did not realise that there was indebtedness between the two companies, he was nevertheless held liable, as his background should have prompted him to read and understand the company's statutory accounts.

recognised recent legislative developments<sup>49</sup> and construed this standard to be the appropriate<sup>50</sup> one expected from modern directors.<sup>51</sup>

Further changes were effected by Hoffmann J in *Norman v Theodore Goddard*<sup>52</sup> where he applied an objective test to observe that a director must possess the skill that may reasonably be expected from someone undertaking those duties. This position would appear to be different from the one proposed in *Re City Equitable Fire Insurance Co*<sup>53</sup> because a degree of professional management or skill on the part of a director is required. Hoffmann LJ in *Re D'Jan of London*<sup>54</sup> also recognised that the duty owed by a director is properly stated in section 214 (4) of the Insolvency Act 1986. As such a qualified or experienced director is judged by higher standards than an inexperienced one.<sup>55</sup>

#### **4.3.2 Standard of Skill and Care Required in Australia**

A high sense of responsibility is required from directors in Australia. Australian judicial decisions have recognised the objective element of the standard of care and diligence owed by a director at common law.<sup>56</sup> The common law decisions were taken into consideration in the amendment of Australian Corporations Law. Section 180 (1), codified the objective duty requiring directors to exercise the degree of care and diligence that a reasonable person in a like position would exercise.<sup>57</sup> In spite of the codification of the objective standard of care, it is worth noting that the

---

<sup>49</sup> This statutory intervention has been rendered as “one of the most important developments in company law this century.” See Prentice, op cit n 47, at 277.

<sup>50</sup> It has been noted that the present position is likely to prompt directors to exercise greater care and skill in order to avoid liability and disqualification under the Insolvency Act 1986 and Company Directors Disqualification Act 1986 (UK). See JH Farrar et al, op cit n 30.

<sup>51</sup> Hoffmann LJ in *Re D'Jan of London Ltd* [1993] BCC 646.

<sup>52</sup> [1992] BCC 14 at 15.

<sup>53</sup> [1925] Ch 407 at 429 Per Romer J.

<sup>54</sup> [1993] BCC 646 at 648-9.

<sup>55</sup> It requires a standard that is expected from a reasonably diligent person having both (a) the general knowledge, skill, and experience that may reasonably be expected from a person carrying out the same functions as are carried out by that director in relation to the company (b) the general knowledge, skill, and experience that that director has.

<sup>56</sup> *Statewide Tobacco Services Ltd v Morley* (1990) 2 ACSR 405; *Commonwealth Bank of Australia v Friedrich* (1991) 5 ACSR 115; *Awa Ltd v Daniels* (1992) 10 ACLC 933; *Group Four Industries Property Limited v Brosnan* (1992) 8 ACSR 468.

<sup>57</sup> The section provides that “[a] director or other officer of a corporation must exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise if they: were a director or officer of a corporation in the corporation's circumstances; and occupied the office held by, and had the same responsibilities within the corporation as, the director or officer.

Australian Parliament obliged the courts to consider (i) the special background,<sup>58</sup> qualifications and management responsibilities of the particular director; and (ii) such matters as the state of the financial affairs of the corporation, the size and nature of the corporation, the urgency and magnitude of any problem, the provisions of the corporation's constitution, and the composition of its board.<sup>59</sup>

Whilst assessing negligence of directors,<sup>60</sup> the Court of Appeal of New South Wales in *Daniels v Anderson*<sup>61</sup> held that directors must bring an informed and independent judgement to the board. This entails reasonable familiarity with the affairs of the company and a requirement to possess a degree of professional management.<sup>62</sup>

The present position in Australia formulates no rule of universal application in regard to director's obligations in all circumstances. Instead, the duty of care depends on the particular function a director performs, the circumstances of the particular case, and the terms on which the director was appointed. So, every act is objectively<sup>63</sup> assessed to establish whether shareholders would reasonably expect directors to pursue a course of action considering the risk of harm and the potential benefits.<sup>64</sup>

A director may still escape liability under certain circumstances where it would be unreasonable to expect every director to have equal knowledge and experience of every aspect of the activities of the company. For instance, where directors are appointed to attract customers, to add to the prestige of the company, or for the special skill possessed, *such subjective factors may be taken into consideration* to offer protection to directors.<sup>65</sup>

---

<sup>58</sup> Courts are obliged to consider the circumstances prevailing at the time of the act complained of without the benefit of hindsight. A court relying on such hindsight can apply too severe standards. See *In re Horsley & Weight Ltd* [1982] Ch 442, 455 per Templeman LJ.

<sup>59</sup> Finch, "Company Directors: Who Cares about Skill and Care?" (1992) 55 MLR 179 at 189.

<sup>60</sup> It followed the conditions applicable in the USA, particularly *Federal Deposit Insurance Corporation v Bierman* (1993) 2 F 3d 1424 (7th Cir); *Francis v United Jersey Bank* (1981) 432 A 2d 814 (NJ); *Federal Deposit Insurance Corporation v Stanley* (1991) 770 F Supp 1281 (ND Ind).

<sup>61</sup> (1995) 37 NSWLR 438.

<sup>62</sup> Ipp, "The Diligent Director" (1997) 18 Co Law 162.

<sup>63</sup> Section 180 (1) of the Corporation Law reinforces the objectivity of the duty of care owed by a director.

<sup>64</sup> *Permanent Building Society v Wheeler* [1993] 11 WAR 187; Ipp, op cit n 62, at 166.

<sup>65</sup> *Daniels v Anderson* (1995) 37 NSWLR 438 at 501.

#### 4.4 Standard of Diligence Required in Kenya

There is no statutory duty in Kenya to attend board meetings. However, Table A of the Act<sup>66</sup> requires a director to vacate his seat if he has been absent for more than six months without permission from meeting of directors held during that period. Although Table A may appear to make mandatory requirements for directors to attend board meetings, it is notable that Table A, being optional, may not be part of the constitution of a company. Besides, the requirements in Table A are not stringent enough, as permission can be granted easily to a director who has a good working relationship with the others. In addition, it is not inconceivable that the company might not hold any meetings within the period, during which a director is absent.<sup>67</sup>

The Kenyan courts have not recognised the need to make it mandatory for directors to attend board meetings. This was illustrated in *Flagship Carriers Ltd v Imperial Bank Ltd*<sup>68</sup> where Mr PJS Hewett, Commissioner of Assize, held that a director is not bound to give continuous attention to the affairs of the company. The courts therefore treat lack of diligence and neglect<sup>69</sup> or omission of duty at board meetings differently.<sup>70</sup> A director is required to attend board meetings when he is reasonably able to do so.<sup>71</sup> As such, his failure to attend board meetings regularly is not necessarily a basis for liability.<sup>72</sup> In the absence of a contractual obligation on

---

<sup>66</sup> Table A Article 88 (f) which is similar to Nigeria's Table A, Article 87 (f).

<sup>67</sup> A director who had been party to a resolution initiating an ultra vires lending policy but was absent from subsequent meetings where specific loans were made pursuant to the policy was held not to be liable in *Cullerne v The London & Suburban General Permanent Building Society* (1890) 25 QBD 485.

<sup>68</sup> High Court Civil Case No 1643 of 1999 (Unreported), Ruling per PJS Hewett.

<sup>69</sup> In *re Denham & Co* (1884) 25 Ch D 752 a founding director was held not to be liable in negligence for recommending a payment of a dividend from capital. In spite of not attending a single board meeting for four years he was absolved from liability.

<sup>70</sup> In *re Cardiff Savings Bank* [1892] 2 Ch 100, the Marquis of Bute had been appointed to the board of the bank at an age of six months, upon assumption of the title of president when his father died. He only attended one board meeting in 39 years even after attaining the age of 21. Despite the failure of the bank as a result of mismanagement, he was held not liable since directors "are only bound to use fair and reasonable diligence in the management of their company's affairs" and failing to attend meetings is not "the same thing as neglect or omission of a duty which ought to be performed at those meetings." Per Stirling J at 109.

<sup>71</sup> This position follows Romer J's proposition in *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407 at 429. This position has also been recognised in recent English and Australian case law. See *Bishopsgate Investment Management Ltd v Maxwell (No 2)* [1994] 1 All ER 261, 263-264 Per Hoffmann LJ; *Permanent Building Society v Wheeler* (1993-1994) 11 WAR 187, 235; and *Daniels v Anderson* (1995) 13 ACLC 614, 662 per Clarke and Sheller JJA.

<sup>72</sup> *Re Denham & Co* (1884) 25 Ch 752 and *Re Marquis of Bute's Case* (1892) 2 Ch 100. In both cases, the two directors involved attended board meetings once in four years and 38 years respectively. They were, however, not held liable for the fraud and irregularities in their companies. Stirling, J in *Re Marquis of Bute's Case* (1892) 2 Ch 100 observed that "neglect or omission to attend

directors to perform specific duties, a company director is only liable for negligence in what he does but not for omitting to attend to the business of the company.<sup>73</sup> A director who fails to prevent other directors from making unwise decisions by his absence from a board meeting is also not liable for negligence.<sup>74</sup>

Although it may be argued that the principles followed by Mr PJS Hewett do not apply to executive directors given that they originated from *Re City Equitable Fire Insurance Co Ltd*,<sup>75</sup> a case which was concerned with non-executive directors,<sup>76</sup> there can be no doubt that they apply to both executive and non-executive directors in Kenya because Mr PJS Hewett did not make a distinction between the two.<sup>77</sup> Moreover, given that the case of *Flagship Carriers Ltd v Imperial Bank Ltd*<sup>78</sup> was only concerned with executive directors, the findings of the judge could not have been made in reference to non-executive directors.

The need to impose a duty on directors to attend board meetings cannot be overemphasised. The need for such a duty is demonstrated by the high quality performance expected by the common law in board meetings. For instance, the assertion in *Ashurst v Mason*<sup>79</sup> by Bacon VC that "it would be in the highest degree dangerous to permit directors to say when any particular incident arises...I was thinking of something else" demonstrates how important board meetings are. It is true to say that a director who takes part actively in the business of the company which results in a loss to the company would be liable in negligence, whereas, he

---

meetings is not, in my opinion, the same thing as neglect or omission of a duty which ought to be performed at those meetings." Contrast with recent judicial authorities in Australia and the UK, namely *Daniels v Anderson* (1995) 37 NSWLR 438 where it was recognised that today a director is expected to attend all meetings unless exceptional circumstances, such as illness or absence from the state, prevent him from doing so.

<sup>73</sup> *Re Brazilian Rubber Plantations and Estates Ltd* [1911] 1 Ch 425.

<sup>74</sup> *Re Forest of Dean Coal Mining Co* [1878] 10 Ch 450 at 452; *Huckerby v Elliot* [1970] 1 All ER 189. In *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407 at 429 a director who was living in Aberdeen and who found it difficult to attend board meetings in London was exonerated from any liability.

<sup>75</sup> [1925] Ch 407 at 429.

<sup>76</sup> *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407 at 429 was concerned with non-executive directors rather than professional directors. See Hicks, op cit n 35, at 392.

<sup>77</sup> The rule was first set out by Romer J in *Re City Equitable Fire Insurance Co* [1925] Ch 407. Although the case was concerned with a non-executive director, Romer J did not distinguish whether the rules would only apply to non-executive directors. The Nigerian Law Reform Commission also considered that the rules set out by Romer J would apply to both executive and non-executive directors. See Nigeria Law Reform Commission, op cit n 36, at 173.

<sup>78</sup> High Court Civil Case No 1643 of 1999 (Unreported), Ruling per PJS Hewett.

<sup>79</sup> (1875) LR 5 Ch App 763, 770.

would not if he abstains from the meeting.<sup>80</sup> It seems inequitable to absolve directors, on one hand, from liability for non-attendance of board meetings and hold them liable, on the other, for not being attentive when they attend.

To resolve this unfairness, the Nigerian Law Reform Commission recommended that directors should be bound by the decision of the board unless it appears to the court that any director should be exonerated.<sup>81</sup> It also recommended that directors should have a duty to attend meetings unless there is a good cause for the director not to attend.<sup>82</sup>

Similarly, the Australian law requires a director to attend all meetings unless exceptional circumstances, such as illness or absence from the State, prevent him from doing so.<sup>83</sup> The Court of Appeal of New South Wales in *Daniels v Anderson*<sup>84</sup> has also maintained that "directors are not excused for shutting their eyes to what is going on around them. In particular, they may not shut their eyes to corporate misconduct and the claim that, because they did not see the misconduct, they did not have a duty to look."<sup>85</sup>

Requiring all directors to be bound by the decision of the board, unless there are special circumstances<sup>86</sup> to exonerate a director, appears to be appropriate because it promotes the diligence of directors.<sup>87</sup>

#### 4.5 Reliance on Others

Whilst some management powers of the company in Kenya are vested in the board of directors,<sup>88</sup> others are reserved to the general meeting.<sup>89</sup> Due to exigencies of

---

<sup>80</sup> Nigeria Law Reform Commission, op cit n 36, p 173.

<sup>81</sup> Ibid p 221.

<sup>82</sup> Ibid p 220.

<sup>83</sup> *Daniels v Anderson* (1995) 37 NSWLR 438; *Vrisakis v Australian Securities Commission* (1993) 1 WAR 395 at 405 per Malcom CJ.

<sup>84</sup> (1995) 37 NSWLR 438.

<sup>85</sup> Ipp, op cit n 62, at 163. In the UK, Hoffmann J in *Bishopsgate Investment Management Ltd v Maxwell (No 2)* [1994] 1 All ER 261 held that a director was liable for lack of activity and taking an interest in the affairs of the company.

<sup>86</sup> Such as illness or absence in the interest of the corporation.

<sup>87</sup> Australian reformers recommended that it should be a rule of law that a director must attend all board meetings unless he has reasonable excuse. Professor Sealy differs with them on the basis that any liability to pay damages or compensation depends on establishing a causal link between the directors' decision and loss to the company rather than inattentiveness or absence. See Sealy, "Reforming the Law on Directors' Duties", [1991] 12 Co Law 175, at 176.

business,<sup>90</sup> both the Act<sup>91</sup> and the courts accept that a director can delegate his duties to another official or a sub committee of the board<sup>92</sup> and he is therefore not liable for the negligence of his delegates.<sup>93</sup> However, directors do not have the power to delegate the powers of management unless the articles of association authorise them to delegate. Article 81 of Table A<sup>94</sup> allows directors to delegate their powers to any company, firm, persons or body of persons. Unless a director suspects fraud, he is not under any obligation to monitor the conduct of the officers to whom he delegates his powers. As such, proper delegation to a committee of the board may be a defence for a director who is not a member of the committee.<sup>95</sup>

Although directors are allowed to rely on others, they are also required to pay attention to all the documents placed before them.<sup>96</sup> Such attention ranges from obligations to verify whether the board has authorised a cheque to be signed<sup>97</sup> to having a complete list of the assets of their company assets before declaring dividends.<sup>98</sup> While the default of one director does not necessarily impose liability on the others, failure to make enquiries when there are suspicious circumstances may be a basis of liability for an innocent director.<sup>99</sup> Therefore, for the reliance of a director on others to be reasonable or justified, the circumstances of delegation are required to give him no ground for suspicion.<sup>100</sup> As such, a director in Kenya would escape liability for delegating his duties where grounds of suspicion do not exist. It

---

<sup>88</sup> Article 80 of Table A of the Act.

<sup>89</sup> Article 47 of Table A of the Act.

<sup>90</sup> Per Romer J in *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407 at 429.

<sup>91</sup> Article 81 of Table A.

<sup>92</sup> *Land Credit Co of Ireland v Lord Fermoy* (1870) 5 Ch App 763.

<sup>93</sup> *Dovey v Covey* [1901] AC 477, 485 the court observed that reasonably wide powers of delegation and reliance are necessary in order not to "render anything like an intelligent devolution of labour impossible.

<sup>94</sup> The Act.

<sup>95</sup> *Land Credit Co of Ireland v Lord Fermoy* [1870] LR 5 Ch 763 where a director was exonerated from liability after relying on a sub committee of the board. The sub-committee of the board had used the funds of the company to buy company's shares in a bid to keep up their price. To do this the sub-committee obtained loans whose purpose was concealed from the board.

<sup>96</sup> Per Romer J in *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407 at 471.

<sup>97</sup> Romer J even suggested that a director should obtain a board's resolution confirming the signature before signing it. However, he suggested that a director could trust the assurances of the relevant officers as to purpose for which the payment was sought. See *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407 at 471. Signing a blank cheque was held to be negligent. See *Dorchester Finance Co Ltd. v Stebbing* in [1980] 1 Co Law 38.

<sup>98</sup> Chairman and auditors' assurances in relation to company's assets are insufficient. See Romer J in *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407 at 471-2.

<sup>99</sup> *Re Lands Allotment Co* [1894] 1 Ch 617.

<sup>100</sup> Per Romer J in *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407 at 429.

is notable that a director is under no obligation to supervise his delegates<sup>101</sup> or to give continuous attention to the affairs<sup>102</sup> of the company.<sup>103</sup> Thus, it is difficult to hold a director accountable for unreasonably delegating his powers because he is unlikely to know of any suspicious circumstances, and he is not required to keep abreast of the affairs of the company or supervise his delegates.

This position is different from the approach adopted by the English courts. The English Court of Appeal has held that each director of a company has a duty to keep abreast of the affairs of the company.<sup>104</sup> Similarly, Australian courts do not absolve directors from liability when they fail to make the appropriate enquiries.<sup>105</sup> Directors in Australia are required to act in good faith and make proper inquiry of the competence of the source, where the circumstances indicate need for it.<sup>106</sup> Directors are also required to exercise a reasonable degree of diligence and honesty and “try to understand or discover sufficient of the company’s financial affairs.”<sup>107</sup> The New South Wales Court of Appeal in *Daniels v AWA Ltd* also held that reliance is unreasonable where the circumstances reasonably awaken suspicion. Clarke and Sheller JJA applied the objective test<sup>108</sup> to conclude that directorial conduct is to be, “ordinarily measured by reference to what the reasonable man of ordinary prudence would do in the circumstances.”<sup>109</sup>

---

<sup>101</sup> *Dovey v Cory* [1901] AC 477 at 493. In *Huckerby v Elliot* [1970] 1 All ER 189 delegation of the task of obtaining a licence exonerated a director from liability when a club operated without a proper licence.

<sup>102</sup> According to Halsbury LC in *Dovey v Cory* [1901] AC 477 at 485 “the business of life could not go on if people could not trust those who are put into a position of trust for the express purpose of attending to details of management.”

<sup>103</sup> Per Romer J in *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407 at 429-9. The case formulated three principles, namely (i) the subjective test of skill which does not require a director to exhibit, in the performance of his duties, a greater degree of skill than may reasonably be expected from a person of his knowledge and experience, (ii) a director is not bound to give continuous attention to the company's affairs, (iii) a director can trust an official to perform duties that can be entrusted to him in accordance with the articles.

<sup>104</sup> *Re Westmind Packing Services Ltd* [1983] Ch 258.

<sup>105</sup> *Daniels v Anderson* (1995) 13 ACLC 614 at 663-666 per Clarke and Sheller JJA. This position was followed in the UK by Jonathan Parker J in *Re Barings Plc (No 5)* [1999] 1 BCLC 433.

<sup>106</sup> Section 189.

<sup>107</sup> *Statewide Tobacco Services Ltd v Morley* (1990) 2 ACSR 405.

<sup>108</sup> Flint, “Non Executive Directors’ General Duty of Care and Delegation of Duty: But Do We Need a Common Law Duty of Care?” (1997) 9 Bond LR 198, at 212.

<sup>109</sup> (1995) 13 ACLC 614, 665.



The standards of care expected from executive directors were also considered and raised in *Daniels v Anderson*.<sup>110</sup> Executive directors were held to have been negligent for failing to establish a proper structure of internal controls, failing to maintain a proper system of records, failing to supervise adequately a particular manager, and failing to act on the warning of the auditor. To avoid liability, directors in Australia have to be involved in the internal supervision of the affairs of the company. In spite of this requirement, non-executive directors are still entitled to rely on managers to “carry out the day to day control of the corporation’s business affairs” and to go carefully through relevant financial and other information of the corporation, to alert the board of any matter requiring attention. Besides, they are also entitled to rely on the Chairman to discharge the “primary responsibility for selecting matters to be brought to the board’s attention”<sup>111</sup> and advice of properly appointed auditors.<sup>112</sup>

Although Hoffmann J in *Norman v Theodore Goddard*<sup>113</sup> recognised that directors are entitled to rely on others,<sup>114</sup> the Australian approach differs from this because directors in Australia are required to keep abreast of the business of the company. It would therefore appear that where a risk is obvious, directors in Australia are not entitled to rely on the judgement of others.<sup>115</sup> The approach adopted in Australia is more stringent than the English one because directors in Australia have the additional obligation of maintaining an awareness of the affairs of the company and undertaking personal investigations. Additionally, directors are not entitled to rely on the integrity of officials to whom responsibilities are delegated.

---

<sup>110</sup> (1995) 37 NSWLR 438.

<sup>111</sup> Per Rogers J in *Daniels v Anderson* (1995) 37 NSWLR 438 at 1015.

<sup>112</sup> Ipp, op cit n 62, at 165.

<sup>113</sup> [1992] BCC 14 at 15.

<sup>114</sup> “A director who undertakes the management of the company’s properties is expected to have reasonable skill in property management, but not in off-shore tax avoidance. See *Norman v Theodore Goddard* [1992] BCC 14 at 15 Per Hoffmann J. In absence of reasonable grounds for suspicion, directors are entitled to rely on others, as business cannot be carried out upon principles of distrust. This position is similar to that proposed by Romer J in *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407 at 429-9.

<sup>115</sup> Under certain circumstances, a director might escape liability in Australia for relying on others. Such circumstances include where a director has no cause to check on the source of information. See *Biala Property Ltd v Mallina Holdings Ltd (No 2)* (1993) 11 ACSR 785.

#### 4.6 Subjective v Objective Standards

Although English and Australian courts adopt objective standards<sup>116</sup> to assess the liability of directors, they also recognise that it is impossible to expect a director to exhibit greater degree of skill than may reasonably be expected from someone undertaking such duties.<sup>117</sup> As such, subjectivity<sup>118</sup> still applies to skill, knowledge, and experience of a director.<sup>119</sup> For instance, Hoffmann J in *Norman v Theodore Goddard*<sup>120</sup> favoured the view that the knowledge, skill, and experience of a director should nevertheless be taken into consideration while assessing what a director might reasonably know. He proposed that the objective test should be applied in light of the subjective circumstances of the director concerned.<sup>121</sup>

The Federal Court of Australia Full Court in *Cummings & Anor v Claremont Petroleum NL*<sup>122</sup> also retained a subjective element on the grounds that, “directors do not form a homogeneous category and necessary skills vary according to differences in sizes and purposes of companies, complexities of management structures, reliance on expert advisers and roles of the particular directors.”<sup>123</sup>

Thus, English and Australian courts apply both subjective and objective standards to assess the negligence of directors. The application of both standards is desirable as it ensures that standards of skill and care are raised without ignoring the individual circumstances of a director. It would be both inequitable and onerous to judge all directors by the same standards as it would, for instance, hinder small businessmen from exercising their free will in selecting directors of private companies. Isaacs and

---

<sup>116</sup> Recommendations were made in Australia to have the duties of care and skill stated in objective terms. See *Report of the Australian Senate Standing Committee on Legal and Constitutional Affairs* (November 1989) (Cooney Report). Cited in Sealy, "Reforming the Law on Directors' Duties", [1991] 12 Co Law 175, at 176.

<sup>117</sup> *Theodore Goddard* [1992] BCC 14. The court considered whether Quirk, a former director of a property company was liable for the money stolen from the company by his co-director Bingham, partner in Theodore Goddard. Hoffmann J held that he had taken reasonable care but taking “into account the knowledge, skill, and experience which he actually had in addition to that which a person carrying out his functions should be expected to have” (at 15).

<sup>118</sup> Interpreting the provision introducing the objective standard, an Australian court in *Byrne v Baker* [1964] VR 443, 450-451 observed that the subjective standard could not be ignored. See Sealy, "Reforming the Law on Directors' Duties", [1991] 12 Co Law 175, at 177.

<sup>119</sup> Ipp, op cit n 62, at 163.

<sup>120</sup> [1992] BCC 14 at 15.

<sup>121</sup> Similar steps had been taken in Australia and the USA.

<sup>122</sup> (1993) 11 ACLC 125.

<sup>123</sup> Finch, op cit n 59, at 203.

Rich JJ in *Gould v The Mount Oxide Mines Ltd*<sup>124</sup> appreciated the impossibility of having an objective standard of the reasonably competent director due to the diversity of companies and businesses. They state that:

“[N]o rule of universal application can be formulated as to a director’s obligation in all circumstances. The extent of his duty must depend on the particular function he is performing, the circumstances of the specific case, and the terms on which he has undertaken to act as a director.”<sup>125</sup>

On the other hand, the consideration of objective elements requires directors to have some degree of common intelligence. It is notable that the application of an objective standard of care in Kenya would make many directors liable in negligence because directors are not required to have any special qualifications to assume office. It would therefore be appropriate to prescribe minimum standards for directors in order to maintain high standards of skill and care.<sup>126</sup> This would introduce professionalism to the board.

#### 4.7 Conclusions

Whilst community, commercial, and company structure<sup>127</sup> changes have influenced Australia,<sup>128</sup> UK, Nigeria, and Canada to raise the standards of care, skill and diligence expected from directors, neither the Kenyan Parliament nor the courts have, so far, addressed the need for changing standards. At the moment, there is no Kenyan authority to suggest that the Kenyan courts would apply the objective test applied in the UK or Australia. In fact, it is true to say that subjective standards are

---

<sup>124</sup> (1917) 22 CLR 490

<sup>125</sup> *Ibid*, at 531. The Cooney Report also recognised the difficulty of having an objective common law standard of a reasonably competent director since “activities of companies are diverse and consequently a range of skills and experience is useful on the boards. See *Cooney Report of the Australian Senate Standing Committee on Legal and Constitutional Affairs* (November 1989), p 28.

<sup>126</sup> Butcher, “Directors’ Duties in the Twenty-First Century: A New Beginning?” [2000] 2 *International Comparative and Corporate Law Journal* 197, at 205.

<sup>127</sup> Rogers CJ attributed evolution of modern company legislation to “demands of changing company structures and commercial practices. See *AWA Ltd v Daniels* (1990) 10 ACLC 933 at 1013.

<sup>128</sup> Australia has enacted legislation that has breathed life into, and raised, standards expected from directors. See Corporations Legislation Amendment Act 1991 (Cth); Corporate Law Reform Act 1992 (Cth); First Corporate Law Simplifications Act 1995 (Cth); Financial Sector Reform (Amendments and Transitional Provisions) Act 1998 (Cth) and Corporate Law Economic Reform Program Bill 1998 (Cth).

applicable in Kenya because Mr PJS Hewett, Commissioner of Assize, in *Flagship Carriers Ltd v Imperial Bank Ltd*<sup>129</sup> did not appreciate the different approaches adopted by English and Australian courts.

The subjective standards of skill and care applicable in Kenya enable directors to escape liability for misconduct. Assessing liability subjectively overly protects directors<sup>130</sup> as they are able to go unpunished by pleading ignorance and inexperience.<sup>131</sup> Since the courts expect directors to exhibit a degree of skill that is commensurate with his experience, a board with skilful directors would be expected to exhibit a higher standard of skill, care, and diligence.

It is important to raise the standards of directors because shareholders are not in a position to track continuously the conduct of directors. They are therefore less effective as policy makers, decision takers, and regulators of directors in the traditional sense.

Although it is impossible to set a universal objective standard, which is required from all directors, as a board consists of directors with diverse qualifications and experiences, it is appropriate to introduce some professionalism on the board in order to raise standards. Given that there is no minimum qualification criteria set for directors, requiring them to be qualified and adopting objective and subjective standard, whilst assessing what they had done in exercising skill and care would raise their standards.

The approach adopted in Australia in respect of delegation of the powers of directors is more stringent and appropriate. This is because directors would not escape liability if they simply relied on the integrity of others, as they have the additional

---

<sup>129</sup> High Court Civil Case No 1643 of 1999 (Unreported), Ruling per PJS Hewett.

<sup>130</sup> In *Dovey v Cory* [1901] AC 477 Cory, a director, wrongfully assented to certain payments and advances having honestly relied on the advice given by Chairman and General Manager of the bank. He was found not to be negligent of his duties after due consideration of his company's business and his position in relation to it. Similarly, Neville J in *Re Brazilian Rubber Plantations & Estates Ltd* [1911] 1 Ch 425 at 437 was of the view that directors are under a duty to exercise reasonable care having regard to their knowledge and experience, which "an ordinary man might be expected to take in the same circumstances on his own behalf."

<sup>131</sup> Nolan, "Company Lawyer Briefing; Maxwell Improper Purposes" (1994) 15 Co Law 85 at 87.

obligation of maintaining an awareness of the affairs of the company and undertaking personal investigations.

It is also necessary to bind directors to the decision of the board unless there is a good cause for the director not to attend. This would promote diligence among directors.<sup>132</sup>

---

<sup>132</sup> Australian reformers recommended that it should be a rule of law that a director must attend all board meetings unless he has reasonable excuse. Sealy differs with them on the basis that any liability to pay damages or compensation depends on establishing a causal link between the directors' decision and loss to the company rather than inattentiveness or absence. See Sealy, "Reforming the Law on Directors' Duties", [1991] 12 Co Law 175, at 176.

## CHAPTER FIVE

### 5.0 ENFORCEMENT OF LIABILITY

#### 5.1 Introduction

Companies serve as strategic media for the conduct of business, which in turn boosts the economy. Companies achieve this objective by being involved in production, transportation, employment and payment of taxes. In spite of their positive role, dishonest and negligent directors, as illustrated in the foregoing Chapters, continue to exploit the existing legal loopholes for personal ends, and this prejudices stakeholders in companies as well as the economy.

Appropriate corporate governance can hardly be realised unless a legal system has in place a mechanism that facilitates prompt and expedient resolution of disputes within a company. In fact, lack of an effective mechanism encourages dissipation of the resources of a company and time in protracted litigation. Moreover, it makes it easy for directors to escape liability after failing to discharge their obligations, especially when directors are able to influence the general meeting. For companies to remain competitive and profitable, investors ought promptly to recover moneys due to them and also recoup losses suffered by them as a result of the action of directors. The efficiency of the Kenyan regulatory framework in relation to directors and in ensuring directorial duties are enforced effectively is examined in this chapter. The analysis is carried out by examining how the Kenyan Companies Act<sup>1</sup> (the “Act”) and the judiciary have sought to protect the rights of investors<sup>2</sup> by providing an effective enforcement mechanism.

#### 5.2 Instituting Proceedings

In general, members of a Kenyan company do not control the company and its operations, as the management is vested in the board of directors.<sup>3</sup> As such,

---

<sup>1</sup> Chapter 486, Laws of Kenya.

<sup>2</sup> Since shareholders are not in a position continuously to keep track of directors’ activities they have been regarded as having “exchanged control for liquidity.” See N Wolfson, *The Modern Corporation: Free Markets Versus Regulation*, (Free Press, 1984) p 20.

<sup>3</sup> Table A of the Act, Article 80.

shareholders cannot exercise powers of management vested in a board of directors. The only opportunity available for them to exercise directorial powers is by altering the articles or “by refusing to re-elect the directors of whose actions they disapprove.”<sup>4</sup> However, given that shareholders might not muster the requisite numbers at a meeting to change the articles, the dissenting minority are bound to accept the decision made by the majority unless they are able to prove oppression by the majority. Where this is the case, shareholders can redress the wrongs of directors by relying on legal remedies.

On various occasions, the Kenyan courts have refused to review the merits of lawful decisions made by shareholders.<sup>5</sup> The courts have been instrumental in allowing shareholders to settle disputes within a company and to comply with majority decisions. The courts have also been reluctant to entertain internal disputes for the purposes of discouraging multiplicity of claims. As a result, if a wrong is done to a company, only the company may institute proceedings for redress, as the legal rights of the company belong to it rather than to the members.<sup>6</sup>

In spite of the contract that exists between a member and a company, and provided for under the Act,<sup>7</sup> courts have refused to recognise<sup>8</sup> that a member has a contractual right to compel the company to act in accordance with all the provisions of the memorandum and articles of association. The rationale for this is the reluctance of the courts to interfere in the internal management of companies.<sup>9</sup> On the other hand, where the intention of the majority shareholders on a matter within the powers of the company is clear, it is not possible for a shareholder to sue in order to rectify any irregularity.<sup>10</sup> Illustrative of the reluctance of the courts to interfere in the internal

---

<sup>4</sup> Per Greer LJ in *John Shaw and Sons (Salford) v Shaw* [1935] 2 KB 113 at 134.

<sup>5</sup> *Musa Misango v Eria Musigire & Others* [1966] EA 390; *Mohamed Mitha and Others v Ibrahim Mitha & Others* [1967] EA 575; *Re Eryeza Bwambale & Co Ltd* [1969] EA430. Also see the remarks of Scrutton LJ in *Shuttleworth v Cox Brothers and Co (Maidenhead) Ltd* [1927] 2 KB 9 at 22-4.

<sup>6</sup> *Musa Misango v Eria Musigire & Others*, op cit n 5; *Foss v Harbottle* (1843) 2 Hare 461; *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* [1982] Ch 204.

<sup>7</sup> s 22 (1).

<sup>8</sup> Courts, however, recognise an individual member’s right where the acts complained of injure a member or are either fraudulent or ultra vires. See *Musa Misango v Eria Musigire & Others*, op cit n 5.

<sup>9</sup> *Musa Misango v Eria Musigire & Others*, op cit n 5.

<sup>10</sup> Per Lord Davey in *Burland v Earle* [1902] AC 83, PC, at 93-4.

management of companies is the case of *Musa Misango v Eria Musigire & Others*.<sup>11</sup> Here the East African Court of Appeal examined whether the plaintiff's control of the activities of the company had been defeated by a change in the articles.

Sir Udo Udoma CJ observed that:

“It is an elementary principle of the law relating to joint stock companies that the court will not interfere with the internal management of companies acting within their powers, and, in fact, has no jurisdiction to do so. It is also clear law that in order to redress a wrong done to the company or to recover moneys or damages alleged to be done to a company, action should prima facie be brought by the company itself... it is true that as a general rule a suit by an individual shareholder or individual shareholders in an incorporated company, complaining of an injury to the corporation, cannot be maintained, if it appears that the plaintiffs have the means of procuring the suit to be instituted in the name of the corporation itself.”<sup>12</sup>

In that case, the Court considered whether the plaintiff, who was the chairman, a director, and the largest shareholder of a limited company, could sue another director and members for depriving him of his offices by special resolutions passed as a result of changes in the articles of the company. Article 48 of the said Articles of Association was changed with a view to defeating the control of the activities of the company by the plaintiff. While the article originally read “each member shall have one vote for every share held by him”, it was changed to read as “each member shall have one vote irrespective of the shares held by him.” These changes were made at meetings convened by members and non-members who had insufficient shares to requisition the meeting or to alter the Articles. In addition, the plaintiff averred that false returns had been submitted to the Registrar of Companies.

---

<sup>11</sup> [1966] EA 390.

<sup>12</sup> Ibid at 396. The position taken here appears to conform to the principles laid down in *Foss v Harbottle*, op cit n 6.



Subsequently, the plaintiff lost his post of director and of chairman. The company was neither a co-plaintiff nor a co-defendant to the action brought by the former chairman. The defence relied on the authorities of *Foss v Harbottle*,<sup>13</sup> *Mozley v Alston*,<sup>14</sup> and *Heyting v Dupont*<sup>15</sup> to argue that the court had no jurisdiction to entertain the suit because the plaintiff was not entitled to the relief sought.

Although the court observed that courts have no jurisdiction to interfere with the internal management of companies acting within their powers and that a company itself ought to sue in order to redress a wrong done to the company or to recover money due to the company, it relied on *Burland v Earle*<sup>16</sup> and *Atwool v Merryweather*<sup>17</sup> to invoke the exception to the said rule. The exception allows a shareholder to sue in his own name if a majority of the shares are controlled by those against whom relief is sought provided that the acts complained of are either fraudulent or ultra vires. As a result, the court upheld the fact that “majority shareholders have no rights to use their votes in such a way as to compromise a suit instituted for the benefit of the company and to retain the benefits obtained by the compromise for themselves, to the exclusion of the minority.”<sup>18</sup>

In finding that the plaintiff was properly before the court, Sir Udo Udoma, CJ observed, *inter alia*:

"He has what is commonly called a right of action, and these decisions which say that, where a wrong is done to the company by the exclusion of a director from the board meetings, the company may sue, and must sue for that wrong, do not apply to the case of a wrong done simply to an individual ... therefore I conclude that I am satisfied that this suit is maintainable in law by the plaintiff in his own right,

---

<sup>13</sup> (1843) 67 ER 189.

<sup>14</sup> (1847) 41 ER 833.

<sup>15</sup> [1964] 2 All ER 273, (CA).

<sup>16</sup> [1902] AC 83.

<sup>17</sup> (1867) LR 5 Eq 464.

<sup>18</sup> *Menier v Hooper's Telegraph Works* (1874) 9 Ch App 350. Similarly, in *Simpson v Westminster Palace Hotel Co* (1860) 2 LT 707, Lord Campbell, LC, observed that the funds of a joint stock company established for the purposes of one undertaking cannot be applied to another. If an attempt to do so is made, such an attempt would be ultra vires even if it is sanctioned by all the directors and by a large majority of shareholders. Thus, any single shareholder has a right to resist it and the court of equity will interpose on his behalf by injunction.

and that this court has jurisdiction to entertain it as the action is brought for injury done to the plaintiff personally by his co-directors and other members of the company.”<sup>19</sup>

Generally, it appears that, unless a wrong is done to an individual, the company is the only entity entitled to sue a delinquent director,<sup>20</sup> as his duties are only owed to the company.<sup>21</sup>

The decision to sue must be decided by the board of directors, which has the authority to institute proceedings in the company’s name. In *Bugerere Coffee Growers Ltd v Sebaduka* <sup>22</sup> an action instituted by an advocate in the name of the company without any resolution of the company or directors was dismissed. In that case a meeting of the members was requisitioned under section 132 of the Act by shareholders holding more than one tenth of the paid up capital. This was as a result of directors failing to call a meeting. At the meeting, a resolution was passed removing all directors and appointing others. An action was thereafter brought in the name of the company challenging the appointment of the new directors. The defendants objected at the outset that the action was incompetent, as the company had not given authority for it to proceed.

Dismissing the action Youds J stated that:

“I find that the letter which Mr. Dholakia handed into the court was and is a highly suspect document, that it is not worth the paper it was written upon as an authority from the company and could not possibly constitute a lawful and proper authority from the company to the firm of advocates

---

<sup>19</sup> *Musa Misango v Eria Musigire & Others* op cit n 5, at 398. The court granted the plaintiff leave to amend his plaint in order to join the company as a co-defendant as failure to do so was bound to result in multiplicity of suits. It is notable, however, that the director was also a shareholder of the company. Thus, the judgement of the court was not against the English position which permits only shareholders to enforce liability. See section 14 of the UK's Companies Act 1985.

<sup>20</sup> Proceedings may be instituted against a de facto or shadow director as well as a retired director, estate of a deceased director, and a bankrupt director. See *Curtis's Furnishing Stores Ltd v Freedman* [1966] 2 ALL ER 955.

<sup>21</sup> *Foss v Harbottle*, op cit n 6.

<sup>22</sup> [1970] EA 147. Also see, *Breckland Group Holdings Ltd v London and Suffolk Properties Ltd* [1989] BCLC 100.

whereby they were to act and commence legal proceedings in the name of the company and on its behalf. When companies authorise the commencement of legal proceedings, a resolution or resolutions have to be passed either at a company or Board of Directors' meeting and recorded in the minutes.”<sup>23</sup>

It follows therefore that if directors command a majority role in a company, it is possible for them to ‘right’ some of their own wrongs at a general meeting.<sup>24</sup> So, a legal action against a director in control cannot be maintained unless control changes hands or a director ceases to be a member of the board.

While shareholders cannot pass an ordinary resolution requiring a board of directors to abandon litigation initiated by the board, unless the articles of association give them the right to instruct the board on such matters, they can pass an ordinary resolution requiring a company to initiate litigation regardless of the opposition of the board.<sup>25</sup>

Shareholders are usually faced with an onerous task when the directors form, and hence control, the majority of the shareholders. In such a scenario, directors can escape liability unless the minority shareholders are able to sue on behalf of the company. The rule in *Musa Misango*<sup>26</sup> maintains that minority shareholders have no right to sue for wrongs done to the company.<sup>27</sup> One of the reasons behind the restriction is the fact that empowering shareholders to enforce directors' duties would encourage wasted litigation.<sup>28</sup>

---

<sup>23</sup> [1970] EA 147 at 154.

<sup>24</sup> In the past, it appeared that if a wrong done to a company cannot be ratified by interested votes then it cannot be ratified at all. Presently, it seems that a wrong which cannot be ratified by interested votes can be ratified by disinterested votes. See *Smith v Croft* (No 2) [1988] Ch 114.

<sup>25</sup> This is so even in instances where articles do not empower shareholders to give instructions to the board.

<sup>26</sup> [1966] EA 390.

<sup>27</sup> For more on *Foss v Harbottle* and minority shareholders see Wedderburn, “Shareholders Rights and the Rule in *Foss v Harbottle*” [1957] CLJ 194.

<sup>28</sup> *Ibid.*

It is worth noting that minority shareholders cannot sue directors, on behalf of the company, when a breach of directors' duties is ratifiable.<sup>29</sup> In *Grant v UK Switchback Railways*,<sup>30</sup> for instance, the court held that since directors' acts which had exceeded their powers were ratifiable by the majority shareholders, they could not be the subject of a minority shareholders' action. Despite this drawback, the rule is helpful because it prevents multiple actions, fruitless actions, and underscores the principles of majority rule and separate legal personality. Commenting on an application made by the plaintiff in *Musa Misango* to amend the plaint in order to join the company as a defendant, Sir Udoma observed that:

“I am also of the view that such an amendment is necessary in the interests of justice as it would avoid multiplicity of suits and enable all matters in controversy between the parties to be determined once and for all.”<sup>31</sup>

Whilst it is true to say that reasonable restrictions on shareholders' rights to institute actions against directors help in forestalling multiplicity of suits and checking against frivolous suits, there is no doubt that shareholders' access to justice may be unfairly restricted where wrongs are committed against them by directors and they are unable to command a majority of the votes for the purposes of suing on behalf of the company.

### 5.3 Rights of Shareholders to Sue

As injustice would flow from strict application of the majority decision rule, namely denying minority shareholders recourse to legal protection, the courts have developed several exceptions, which allow minority shareholders to litigate on behalf of the company with a view to enforcing their rights.<sup>32</sup> Where a minority shareholder has suffered personal loss in addition to the harm occasioned to the

---

<sup>29</sup> *Burland v Earle* [1902] AC 83.

<sup>30</sup> (1888) 40 Ch 135 (CA).

<sup>31</sup> *Musa Misango v Eria Musigire & Others* op cit n 5, at 400.

<sup>32</sup> Such an action is termed as a derivative action because the minority derive the right to sue from the company's right. The company must be joined as a party in a derivative action in order to prevent the company suing again in its own name and on the same facts. See *Spokes v Grosvenor Hotel Co* [1897] 2 QB 124.

company, the exceptions allow him to bring a representative action on his own behalf and on behalf of other shareholders who have suffered similar harm. Personal representative suits reduce the threat of multiplicity of suits. Other instances which have traditionally seen the application of the exceptions include: where the wrong complained of is an illegal or ultra vires transaction;<sup>33</sup> where the matter is one which can be validly done or sanctioned not by a simple majority, but only by some special majority; and where the majority is committing a fraud on the minority.<sup>34</sup>

Although the East African Court of Appeal has recognised the rights of shareholders to institute suits in certain circumstances,<sup>35</sup> it is important to examine whether the present state of affairs provides an effective machinery for redressing wrongs committed by directors. At present, a shareholder who is desirous of suing a director must do so within the exceptions laid down in *Musa Misango v Eria Musigire & Others*.<sup>36</sup> The minority shareholders wishing to institute proceedings can bring a personal action, a representative action, or a derivative action. A personal action arises where there has been a violation of the rights that accrue personally to the shareholder under the memorandum and articles of association.<sup>37</sup> A representative action, on the other hand, refers to an instance where proceedings are collectively instituted by a number of members having similar interests or rights which have been infringed.<sup>38</sup> A derivative action originates from the right of the company to sue in its corporate capacity. Although it seems to be similar to a representative action, the plaintiff in a derivative action does not act as a representative of other shareholders but as a representative of the company. To assess whether these exceptions are exhaustive enough, we shall examine each one of them in turn.

---

<sup>33</sup> In *Edwards v Halliwell*, Jenkins LJ observed that any act which according to the articles of association ought to be done by special majority fell outside the rule in *Foss v Harbottle*. He opined that, "a company which, by its directors, had broken its own regulations by doing something without a special resolution which could only be done validly by a special resolution, could assert that it alone was the proper plaintiff in any consequent action, and the effect would be to allow a company acting in breach of its articles to do de facto by ordinary resolution that which according to its own regulations could only be done by special resolution." See [1950] 2 All ER 1064 at 1067. Since the articles of association constitute a contract between the company and its members, derivative actions provide an avenue for the shareholders to enforce contractual terms.

<sup>34</sup> *Musa Misango v Eria Musigire & Others*, op cit n 5.

<sup>35</sup> Ibid.

<sup>36</sup> Op cit n 5.

<sup>37</sup> Nigerian Law Reform Commission, *Working Papers on the Reform of Nigerian Company Law*: Volume 1-Review and Recommendations, 1987, p 237.

### 5.3.1 *Personal Rights*

Observing that a personal action could be brought by an individual shareholder in his own right, Sir Udoma in *Musa Misango v Eria Musigire & Others*<sup>39</sup> stated that section 13 of the Uganda Companies Ordinance,<sup>40</sup> under which the defendant had purported to act in altering the articles of the company, could not be a justification for forcing the changed article on the minority because the proposed article was not just and equitable or for the benefit of the company as a whole, but was simply for the benefit of the majority.

Where a duty is owed to an individual shareholder, rather than a company, the shareholder concerned has the discretion of enforcing his right. However, such a shareholder would not be capable of correcting an irregularity, in the conduct of the company's affairs, which is capable of ratification in the general meeting.<sup>41</sup> Where ratification is possible it is not necessary to show that the defendant wrongdoers are in control of the company. However, where the wrong complained of is a past ultra vires act, the vindicated right ceases to be personal and becomes corporate.<sup>42</sup> Since the memorandum and articles of association constitute a contract between the company and each shareholder, a breach of the memorandum and articles confers rights upon individual shareholders to maintain an action without being barred by the rule in *Musa Misango v Eria Musigire & Others*.<sup>43</sup> In addition, any instance of conducting the company affairs in disregard of the articles' provisions would constitute a breach of a shareholder's personal rights to have affairs of the company conducted properly. Notwithstanding the need to hold a company to the "procedures which it itself has adopted in its constitution for its internal decision making,"<sup>44</sup> courts do not recognise the conferment of enforcement rights to shareholders in cases where an internal irregularity would be rectified in a general meeting.<sup>45</sup>

---

<sup>38</sup> Ibid.

<sup>39</sup> Op cit n 5.

<sup>40</sup> No 1 of 1958.

<sup>41</sup> *Prudential Assurance Co Ltd v Newman Industries* (No) [1982] Ch 204 (CA).

<sup>42</sup> Prentice, "Shareholders Actions: The Rule in *Foss v Harbottle*" (1988) 104 LQR 341 at 342.

<sup>43</sup> [1966] EA 390.

<sup>44</sup> PL Davies, *Gower's Principles of Modern Company Law*, (Sixth Edition, Sweet & Maxwell, 1997), p 662. Also see Smith, "Minority Shareholders and Corporate Irregularities" (1978) MLR 147.

<sup>45</sup> In *MacDougall v Gardiner* (1875) 1 ChD 13 the decision of the chairman of the shareholders' meeting to refuse to request a poll, was held to be an internal irregularity which could be rectified in the General Meeting. In *Pender v Lushington* (1877) 6 ChD 70 refusal of a chairman to recognise the votes attached to shares held by nominee shareholders was held to infringe their personal rights.

An individual action of a shareholder to enforce his rights would not be effective if he seeks to have corporate relief.<sup>46</sup> However, where the source of the right of the individual shareholder is not in the constitution of the company, a shareholder's enforcement right cannot be affected. Therefore, there is a blurred distinction between breach of the provisions of the articles which would infringe the personal rights of a shareholder and the ones which would be forbidden by the rule in *Foss v Harbottle*. It would appear that each member should have a prima facie right to enforce any breach of duty whether it affects him alone or as part of the membership.

### 5.3.2 Fraud on the Minority

Where a company fails to take action, for instance where the wrongdoer controls the company, a shareholder may bring a derivative action<sup>47</sup> in his own name, but on behalf of himself and the company.<sup>48</sup> Although such a shareholder would be suing on behalf of the company, rather than on behalf of the members, the members' representative notion is congruent with the rule in *Musa Misango v Eria Musigire & Others*,<sup>49</sup> which seeks to avoid multiplicity of actions against the company.

The need to protect the minority was recognised by the Kenyan Court of Appeal in *LeisureLodges Ltd v Yashvin A Shretta*<sup>50</sup> where the respondent sought to have the appellant company wound up on the ground that the minority shareholders had been excluded from its effective management, and that they were being oppressed by

---

<sup>46</sup> In *Taylor v NUM (Derbyshire Area)* [1985] BCLC 237 the plaintiff successfully restrained the officials of the union from continuing a ultra vires strike, but his claim for an order requiring the same officials to restore to the unions the funds already expended failed as he did not meet the requirements of *Foss v Harbottle*. Such a right belonged to the company.

<sup>47</sup> Order 15 rule 12 A (1) of the Supreme Court rules (UK) defines a derivative action as one "begun by writ by one or more shareholders of a company where the cause of action is vested in the company and relief is accordingly sought on its behalf."

<sup>48</sup> A member who is instituting an action is required to join the company in the action as a defendant. Where a company is under liquidation, the liquidator may sue for any breach of duty relating to the company without commencing new proceedings. Jurisdiction extends to any person who has been concerned with the promotion, formation, or management of the company. See similar provisions under the British Insolvency Act 1986, s 212. *Re Clasper Group Services Ltd* [1989] BCLC 143 underscores the fact that liability does not extend to those who exercised clerical or other non-management functions.

<sup>49</sup> [1966] EA 390.

<sup>50</sup> Court of Appeal (Kenya) on 18th April, 1997 (Coram: Omolo, Tunoi, and Shah JJA) Civil Appeal Number 10 of 1997.

directors.<sup>51</sup> It was contended that the company had amended the Articles of Association and, as a result, permitted new people fraudulently to become shareholders in disregard of the articles. The course of events made the minority wary of the danger that assets may be stolen or wasted by the majority. The minority shareholders contended that the majority were, among other things, collecting money fraudulently from foreign debtors of the company and failing to account for it. As a result, the court appointed a provisional liquidator to protect the property.

Although the rule in *Musa Misango v Eria Musigire & Others*<sup>52</sup> discourages multiplicity of suits and wasted litigation by requiring the decision to sue to be taken by majority shareholders in a general meeting<sup>53</sup>, there is room to argue that it may also encourage errant directors to stifle the institution of litigation against them.<sup>54</sup> This may, for instance, happen when the minority shareholders are not able to prove that the majority shareholders are fraudulent. As such, although it is clear that Kenyan courts would entertain a derivative action if there is fraud on the minority, they might not adopt the same approach if what was complained of was negligence rather than fraud.<sup>55</sup> In fact, 89 percent of the respondents who took part in a survey conducted in 2001 in Nairobi agreed with the statement that there is no effective enforcement of liability.<sup>56</sup>

Unlike the Kenyan courts, courts in other jurisdictions<sup>57</sup> have shown the tendency not to apply the rule in *Foss v Harbottle* (*Musa Misango v Eria Musigire & Others*) when it stands in the course of justice. The courts have been flexible enough to find negligence, which not only harmed the company but also resulted in a profit to a

---

<sup>51</sup> Section 211 of the Act enables a member of a company who complains of oppression in the conduct of the affairs of a company to petition the court for a winding-up order.

<sup>52</sup> [1966] EA 390.

<sup>53</sup> PL Davies, *op cit* n 44, p 658.

<sup>54</sup> Professor Bottomley observes that: "where the board or a majority of the members decide against legal action then, generally speaking, under the rule in *Foss v Harbottle*, that is the end of the matter." See S Bottomley, "Shareholders Derivative Actions and Public Interest Suits: two versions of the same story?" (1992) 15 (1) *University of New South Wales Law Journal* 127 at 138. Cited in Prince, "Australia's Statutory Derivative Action: Using the New Zealand Experience" (2000) 18 *CSLJ* 493 at 496.

<sup>55</sup> *Pavlides v Jensen* [1956] Ch 565. Even gross negligence was not sufficient in *Cook v Deeks* [1916] 1 AC 554.

<sup>56</sup> The survey is discussed in detail in Chapter Nine.

<sup>57</sup> Australia's Corporations Act 2001 provides for a right to bring a "statutory derivative action". See as Pt 2F 1A Companies Act 1993 of New Zealand has a similar provision. See s 165.



director, to be fraud on the minority.<sup>58</sup> In *Daniels v Daniels*<sup>59</sup> the need to show bad faith on the part of the defendant was removed by Templeman J when he broadened the exception thus:

“A minority shareholder who has no other remedy may sue where directors use their powers, intentionally or unintentionally, fraudulently or negligently, in a manner which benefits themselves at the expense of the company.”<sup>60</sup>

In an attempt to overcome the barriers of *Foss v Harbottle*, New Zealand enacted sections 165-168 of the Companies Act 1993,<sup>61</sup> which introduced a statutory derivative action. The statutory provisions in New Zealand have abolished the need to prove that a certain level of fraud has been committed before proceedings could be brought. Similarly, it is not necessary to show that the “interests of justice” were sufficient to attract relief. Instead, the statutory provisions focus on whether or not the company is willing to take action to right the wrong done to it. They also provide room for considering the company’s interests and having the proceedings controlled by someone else other than its directors or majority shareholders.<sup>62</sup>

Before introduction of the statutory derivative action in New Zealand, the courts had already adopted a liberal approach to interpreting the rule in *Foss v Harbottle*, as the rule was considered to be an impediment<sup>63</sup> to shareholders’ rights of enforcement. *In fact, since the concepts of unfairness and interests of justice had replaced the “fraud on the minority” exception, the courts allowed derivative as well as personal causes of action where legitimate expectations had been breached.*

---

<sup>58</sup> *Daniels v Daniels* [1978] Ch 406 at 414.

<sup>59</sup> [1978] Ch 406 at 414.

<sup>60</sup> *Ibid.*

<sup>61</sup> The Act was enacted in July 1994. It followed recommendations made by the New Zealand Law Commission in 1989; The Law Commission, *Company Law Reform and Restatement*, NZLC R9 (1989) para 564-571.

<sup>62</sup> Berkahn, “Derivative Action in Australia and New Zealand”, (1998) 10 Bond LR 74 at 75.

<sup>63</sup> Although the New Zealand Law Commission had actually expressed doubts whether the rule was actually an impediment, it concluded that it was. See New Zealand Law Commission, *Company Law: A Discussion Paper*, (1987), para 46-47 and 564.

Ruling on the issue of standing in *Berlei Hestia (NZ) Ltd v Fernyhough*<sup>64</sup> Mahon J observed:

“There can be no doubt that a shareholder in a company, while having no purely statutory right to enforce compliance by directors with their accounting duties, may yet rely on his proprietary rights to bring about the same result.”<sup>65</sup>

It is evident that judicial interpretations of the statutory provisions in New Zealand strike a balance on the one hand between giving shareholders a reasonable opportunity to right corporate wrongs, and on the other limiting shareholders’ actions when more suitable alternatives are available.<sup>66</sup>

In Australia, the Corporations Act 2001 adopts similar provisions which are geared towards addressing the inadequacies of the common law action.<sup>67</sup>

The Western Australian Supreme Court in *Cope v Butcher*<sup>68</sup> recognised the “interest and justice” principle<sup>69</sup> as an exception to the rule in *Foss v Harbottle*.<sup>70</sup> Also, in *Bancorp Investments Ltd v Primac Holdings Ltd*,<sup>71</sup> although the issue in question was regarded as a matter of internal corporate procedure, McPherson J granted leave to commence proceedings.<sup>72</sup> Similar facts might be sufficient in the UK to see the granting of an opportunity to a shareholder to right the wrongs of a company under section 459 of the Companies Act 1985.

---

<sup>64</sup> [1980] 2 NZLR 150.

<sup>65</sup> Ibid at 155.

<sup>66</sup> Berkahn, op cit n 62, at 100.

<sup>67</sup> s 236.

<sup>68</sup> (1996) 20 ACSR 37.

<sup>69</sup> A member may invoke the exception if directors’ conduct is unfairly prejudicial to the interests of the members.

<sup>70</sup> The same exception is also recognised in New Zealand. See Berkhan, “The Derivative Action in Australia and New Zealand: will the statutory provisions improve shareholders’ enforcement rights” (1998) 10 Bond Law Review 74 at 81-83. Cited in Prince, op cit n 54, at 497.

<sup>71</sup> (1984) 9 ACLR 263.

<sup>72</sup> Berkhan, “The Derivative Action in Australia and New Zealand: will the statutory provisions improve shareholders’ enforcement rights” (1998) 10 Bond LR 74 at 88.

### 5.3.2.1 Control

In Kenya, for an individual shareholder to pursue a suit on the ground of fraud on the minority, he has to prove that the defendant has overwhelming control of the company.<sup>73</sup> Other jurisdictions, such as New Zealand, have abolished the need to prove control of the company by the defendant.<sup>74</sup> Although early cases equated control with voting rights,<sup>75</sup> some courts in recent times have held *de facto* control<sup>76</sup> by the wrongdoer to be sufficient. Such cases include cases where: shareholders are offered inducements to vote in favour of the wrongdoer;<sup>77</sup> defendants are able to determine the outcome of a resolution in their own favour by use of proxy votes.<sup>78</sup> The court can still exercise its discretion to deny a member the right to sue. For instance, where a member has participated in the wrong, he is barred from suing.<sup>79</sup> However, the buying of shares with a view to being a plaintiff is not a ground for denying a proposed plaintiff the right to sue.<sup>80</sup> This position is not entirely desirable because it gives enough room to a litigious individual to use a company's resources in vexatious lawsuits. It is important, therefore, to take into consideration the circumstances under which the shares were acquired.<sup>81</sup>

### 5.3.3 Ratification

A derivative action cannot be maintained in Kenya to enforce company's rights where the wrong in question is ratifiable by the company in a general meeting by ordinary resolution. Such an approach is in accord with the view expressed by Sir Udo Udoma in *Musa Misango v Eria Musigire & Others*<sup>82</sup> where he observed that an individual member of the company cannot sue where the alleged wrong is a

---

<sup>73</sup> *Musa Misango v Eria Musigire & Others*, op cit n 5.

<sup>74</sup> Prior to invoking the statutory derivative action in New Zealand, a plaintiff was required to seek leave of the court before commencing proceedings in the name and on behalf of the company. Section 165 (1), Companies Act 1993 (NZ).

<sup>75</sup> *Burland v Earle* [1920] AC 83 at 93.

<sup>76</sup> This kind of control may arise when a person having minority voting control is able to secure the passing of an ordinary resolution in a meeting which is not attended by many shareholders. See Griffin S, *Company Law: Fundamental Principles*, (3rd edition, Pearson, 2000) p 332.

<sup>77</sup> *Atwool v Merryweather* (1867) LR 5 Eq 464.

<sup>78</sup> *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* [1981] Ch 257 at 324.

<sup>79</sup> As an equitable right it can be denied, for instance, where the plaintiff is guilty of the wrong he complains of or where the claim is pursued for ulterior motives rather than for the benefit of the company. See *Whitwam v Watkin* (1898) 78 LT 188; *Nurcombe v Nurcombe* [1985] 1 WLR 370.

<sup>80</sup> *Whitwam v Watkin* (1898) 78 LT 188, *Towers v African Tug* [1904] 1 Ch 558, CA.

<sup>81</sup> Ghana's Companies Act section 210 provides for that situation.

<sup>82</sup> [1966] EA 390.

transaction which might be made binding on the company and all of the members by a simple majority of the members.<sup>83</sup>

A derivative action can only be brought where: the wrongdoers are in control of the company;<sup>84</sup> ultra vires actions have occurred; or in cases involving special majorities.<sup>85</sup> However, an action cannot proceed when a majority of those who constitute the minority does not support the action.<sup>86</sup> The independent organ is not necessarily composed of shareholders, as the composition varies “according to the constitution of the company concerned and the identity of the defendants.”<sup>87</sup> Thus, it is possible for a board of directors to constitute an independent organ and, therefore, rightly resolve not to bring an action. The recognition of the board’s independence may bar derivative actions, especially where members of the board are the ones in breach of duties. Although courts in the USA and other jurisdictions have maintained that a derivative action cannot be barred by a resolution of an “independent litigation committee”,<sup>88</sup> the question has yet to be examined in the Kenyan courts.

Under some circumstances, an individual shareholder can still sue even where the wrong is ratifiable.<sup>89</sup> Allowing shareholders to maintain actions on ratifiable questions may pose some danger to the company where the general meeting ratifies the wrong before a judgement is entered, thus making litigation invalid and bringing it to an abrupt end at the cost of all the parties involved.<sup>90</sup>

If the wrong is not ratifiable, it cannot be said that wasted litigation would arise. The prime consideration in such a scenario is to find the appropriate collective body to take decisions on litigation. While the general meeting may be left to litigate over

---

<sup>83</sup> Jenkins LJ in *Edwards v Halliwell* [1950] 2 All ER 1064 at 1066.

<sup>84</sup> Fraud on the minority. See *Edwards v Halliwell* [1950] All ER 1064 at 1066. The distinction between fraud and other non-fraudulent wrongs lies in whether the breach of duty can be ratified by the shareholders by ordinary resolution. Fraudulent acts are classified as wrongs done to the shareholders rather than to the company. For a detailed analysis see Wedderburn, op cit n 27.

<sup>85</sup> *Edwards v Halliwell*, ibid at 1066 Per Jenkins LJ.

<sup>86</sup> *Smith v Croft (No 2)*, op cit n 24.

<sup>87</sup> Per Knox J in *Smith v Croft (No 2)* [1987] 3 WLR 405 at 459.

<sup>88</sup> Prentice, op cit n 42, at 345.

<sup>89</sup> *Hogg v Cramphorn Ltd* [1967] Ch 254 where it was held that unlawful exercise of power constituted an abuse of the contractual obligation of a company to the shareholders and, hence, the plaintiff shareholder was allowed to sue.

fraud if the wrongdoers are not in control,<sup>91</sup> the “majority of the independent minority”<sup>92</sup> has the mandate to litigate when the wrongdoers are in control.<sup>93</sup> In spite of fulfilment of the conditions requisite to maintaining a derivative action, it would be erroneous to assert that individual member’s rights to maintain an action, where a wrong is not ratifiable, are unfettered. It will be seen, therefore, that a derivative action remains a weapon of last resort rather than a “normal part of the enforcement apparatus of the law.”<sup>94</sup>

#### 5.3.4 *Statutory Protection*

The Act has sought to protect minority interests in a company by enabling the courts to intervene in the internal management of companies and offer protection to any member without prejudicing the company’s viability.<sup>95</sup> The Act gives shareholders various rights for the purposes of protecting minority rights. These rights include:

- The rights of holders of special classes of shares to challenge the variation of the rights attached to any class of shares in the company.<sup>96</sup>
- The right of the registrar of companies to investigate the company.<sup>97</sup>
- Protection of minority shareholders in the case of schemes of reconstruction and amalgamation.<sup>98</sup>
- The right of the court to restrict alteration of the objects of the company.<sup>99</sup>
- The right of any member of a company who complains of the oppressive nature of the conduct of the affairs of the company to some part of the members to

---

<sup>90</sup> *Wallersteiner v Moir* (No 2) [1975] QB 373 (CA).

<sup>91</sup> Control has been illustrated in terms of de jure control, namely control of at least a majority of the votes capable of being cast at a general meeting. See *Pavlides v Jensen* [1956] Ch 565. It has also been construed to mean “a wide spectrum extending from an overall absolute majority of votes at one end to majority of votes at the other end made up of those likely to be cast by the delinquent himself plus those voting with him as a result of influence or apathy.” See *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* [1981] Ch 257 at 291 Per Vinelott J.

<sup>92</sup> For a detailed analysis see Prentice, op cit n 42, at 34; Davies, “Enforcement of Directors’ Duties” [1985] JBL 318.

<sup>93</sup> *Smith v Croft (No 2)* [1988] Ch 114 Per Knox J.

<sup>94</sup> PL Davies, op cit n 44, p 676.

<sup>95</sup> The Act, s 211.

<sup>96</sup> Ibid s 74.

<sup>97</sup> Ibid s 164.

<sup>98</sup> Ibid s 267.

<sup>99</sup> Ibid s 7.

make an application to the court by petition for an order to regulate the affairs of the company.<sup>100</sup>

The last safeguard is the most useful in protecting shareholders' interests, as it allows the courts to make a winding-up order and to exercise their discretion in making other alternative orders as they deem fit if they are of the opinion that a winding-up order would unfairly prejudice the members concerned.<sup>101</sup> The section allows any member or the Attorney-General<sup>102</sup> to make an application to the court.

Under the section, however, the courts can only interfere in the internal management of the company if the affairs of the company are being conducted in an oppressive manner and that it would be just and equitable to wind up the company. Moreover, the court can only intervene when a course of conduct, rather than an isolated act, is complained of. Also, it is not possible to invoke the section despite the hardship suffered by directors, employees, creditor, or debenture-holder, as they are not members.<sup>103</sup> As will be seen, corresponding provisions in others jurisdictions are not as restrictive as these provisions.

While the section provides the courts with powers to protect oppressed shareholders, the same protection is not afforded to shareholders who are unable to discharge the onerous burden of proof on their shoulders, notably that it is just and equitable to wind up the company and the affairs are oppressive. Given that the Act does not

---

<sup>100</sup> Ibid s 211.

<sup>101</sup> This position appears to be similar to that recommended by the Cohen Report, which culminated in section 210 of the UK's Companies Act. The Report noted that the minority did not necessarily benefit from a company's winding-up where they were being oppressed. It therefore recommended empowerment of the courts to examine their discretion by prescribing alternative remedies to end the oppression. Section 459 of the UK's Companies Act 1985 repealed section 210 of the UK's 1948 Act and enacted a new provision based on unfair prejudice rather than oppression. Under the new section, it is not necessary to show actual illegality or invasion of legal rights. Under the section, a single prejudicial act or omission which has taken place or proposed is enough to invoke the section.

<sup>102</sup> The Attorney-General is empowered to petition when the case falls under section 170 (2), which allows the Attorney General to petition for a winding-up order.

<sup>103</sup> Section 26 of the Act refers to members as subscribers to the memorandum of association who become members on its incorporation. It also refers to any other person who agrees to become a member and whose name is entered in the register. In *Re Jermyn Street Turkish Baths Ltd* [1970] 3 All ER 57 at 67, the term member was interpreted to include a deceased member's personal representative. Also see *Re Lundie* (1965) 2 ER 692.

offer guidance as to what might be termed “oppressive conduct”, the natural meaning of the term may leave little room for petitions to succeed.<sup>104</sup>

The East African Court of Appeal has held that being outvoted is not in itself evidence of oppression. In *Re Eryeza Bwambale & Co Ltd*<sup>105</sup> the minority shareholders sought the appointment of inspectors to investigate the affairs of the company on the basis that the second respondent, the majority shareholder, was dictatorial and had failed to give them sufficient information about the company’s affairs, and that the company had failed to declare a dividend.

Dismissing the application, Goude J stated that:

“There is no proof that the second respondent has prevented the calling of any extraordinary general meeting. In fact one was called and attended by sixteen members. The fact that they could not by their vote do anything effective is another matter. If they wish to contend that the affairs of the company are being conducted in such a way as to be oppressive to minority shareholders other possible remedies are available to the minority, but the mere fact that they find *themselves automatically outvoted* certainly is not in itself evidence of oppression.”<sup>106</sup>

Illustrative of the difficulty<sup>107</sup> in fulfilling the requirements laid down under section 211 is the case of *Mohamed Mitha and Others v Ibrahim Mitha and Others*<sup>108</sup>

---

<sup>104</sup> Only two successful petitions were made under section 210 of the Companies Act 1948 UK. See *Re Hammer Ltd* [1958] 3 All ER 689 and *Scottish CWS Ltd v Meyer* [1950] AC 324. Following recommendations made by the Jenkins Committee, Section 210 of the Companies Act, UK, was amended to read “unfairly prejudicial conduct” instead of “oppressive conduct.” Afterwards, several Commonwealth countries amended their provisions as well. This was carried out in India, Canada, New Zealand, and Australia. See The Report of the Company Law Committee, Chaired by Lord Jenkins (1962) Cmnd 1749; *Working Papers on the Reform of Nigerian Company Law*, op cit n 37, p 245.

<sup>105</sup> [1969] EA430.

<sup>106</sup> *Ibid* at 431.

<sup>107</sup> Jenkins Committee (UK) also recognised that a case for winding-up under the just and equitable ground was difficult to establish by contributories. It, therefore, ought not to be a condition for the protection of the oppressed. See The Report of the Company Law Committee, Chaired by Lord

where four brothers, who were the first shareholders of a company with a nominal capital of 900 ordinary shares, were appointed permanent directors for life. One of the brothers, Haji, was appointed the permanent managing director with a casting vote. Subsequently, differences arose between the four brothers and by agreement Haji and another brother, Alibhai, left the company and transferred their shares to Ibrahim and Mohamed. After the transfer, the petitioners' (Mohamed, his wife, and son, Sadrudin) shares totalled 360 while the respondents' (Ibrahim, his wife, and two sons, Tajdeen and Sultan) totalled 540. Mohamed and Ibrahim appointed their respective sons, Sadrudin and Tajdeen, to be co-directors and to fill the places left vacant by the departure of Haji and Alibhai. However, a deadlock occurred between the two groups, namely Mohamed and his son on the one hand, and Ibrahim and his son on the other. To resolve the dispute a general meeting was held and an ordinary resolution was passed by the majority (Ibrahim's family) appointing Ibrahim's son, Sultan, to replace Sadrudin. The passing of this resolution was challenged by the petitioners on the basis that principles of fair management were not observed. As a result, the petitioners claimed that the conduct was oppressive and sought to invoke section 211 of the Act to redress the oppression. The petitioners feared that the property of the company would be diverted to their detriment and, therefore, sought to have the court order the respondents to sell their shares to the petitioners on such terms as the court should think fit or the company be wound up.

In his judgment Russel J, first, considered whether the circumstances were such that a winding-up order on those grounds would be justified. Second, he considered whether it was just and equitable for the company to be wound up as a preliminary step to granting the relief prayed for under section 211. Russel J held that the petitioners had failed to prove any hardship or oppression. He also held that the respondents had not acted without probity in the conduct of the company's affairs. Since the petitioners were unable to prove that it was just and equitable to make a winding-up order, the question whether any other order would be just and equitable did not arise.

---

Jenkins (1962) Cmnd 1749; *Working Papers on the Reform of Nigerian Company Law*, op cit n 37, p 246.

<sup>108</sup> [1967] EA 575.



Commenting on the resolution passed to appoint Sultan in place of Sadrudin, Russel J observed that:

“This appears to have been a reasonable and businesslike course to adopt in order to avoid perpetrating the dead lock and so that the business of the company could be contained..... I am satisfied that the various decisions arrived at by the company as set out in the said minutes are fully capable of being regarded as being in the best interest of the company and that there has not been any lack of probity by the respondents in the conduct of the company affairs. The petitioners have failed to satisfy me that there are any facts, which would justify the making of a winding-up order on the ground that it would be just and equitable to do so. As this is an essential step preliminary to any order being made under section 211 of the Companies Act and as I have already come to a decision as to the other prayers I have no alternative but to dismiss the petition with costs.”<sup>109</sup>

It would appear that the task of proving that a company ought to be wound up is not an easy one. Similar difficulties in discharging the onerous burden are illustrated in *Sverre Haug and Others v Buhemba Mines*.<sup>110</sup> In that case the respondent company issued 1000 redeemable preference shares of which 988 were redeemed out of profits. Subsequently in 1944 the company issued 900 redeemable preference shares in place of 900 of the redeemed shares. Of the second issue, 847 shares remained unredeemed. The appellants held 472 of the 847 redeemable preference shares. The directors refused to redeem the shares and the appellants sought an order to wind up the company, primarily to obtain a return of their capital. They claimed, in proceedings initiated after 1950, that it was just and equitable that the company should be wound up, as the 847 shares were redeemable not later than 1 January 1950. The failure to redeem the shares, coupled with a falling in arrears of the

---

<sup>109</sup> *Mohamed Mitha and Others v Ibrahim Mitha and Others*, op cit n 5, at 582.

<sup>110</sup> (1953) 20 EACA 28.

dividends on the said shares, meant that there were no means by which they could receive payment of their capital and arrears of dividends, apart from liquidation.

Although there were no profits available to redeem the shares, the East African Court of Appeal declined to issue a winding-up order for the reason that the company was not insolvent, directors of the company had not acted without probity or efficiency, and the irregularities referred to were insufficient to lead to the making of a winding-up order. Pronouncing his judgment, Sir Hector Hearn CJ observed that:

"There is no question of insolvency, or of the substratum of the company having gone, or of the company doing something which is ultra vires its constitution. There is no allegation of a deadlock or of fraud or want of bona fides or lack of commercial probity or efficiency."<sup>111</sup>

Although an individual shareholder in Kenya seeking a relief under the ground of oppression would have to prove that it is just and equitable for the company to be wound up, such onerous conditions do not exist in other jurisdictions. In New Zealand, for instance, shareholders are no longer required to show lack of probity or want of good faith<sup>112</sup> on the part of directors.<sup>113</sup>

Australia also has a provision for oppressive remedy,<sup>114</sup> which abolished the need to show lack of probity or want of good faith on the part of directors for the courts to grant an oppressive remedy. Section 232 of the Corporations Act 2001 allows a member to make an application in relation to a company if he believes the affairs of the company are being conducted oppressively, unfairly, discriminatory, and

---

<sup>111</sup> *Sverre Haug and Others v Buhemba Mines* (1953) 20 EACA 28 at 36.

<sup>112</sup> *Thomas v HW Thomas Ltd* [1984] 1 NZLR 686 at 693.

<sup>113</sup> This has been made possible by the liberalised approach adopted by the courts following enactment of section 174 of the Companies Act 1993. Although the liberalised approach enhanced shareholders' rights to remedy personal wrongs, it did not enhance shareholders' ability to enforce corporate causes of action. See Berkahn, *op cit* n 62, at 91.

<sup>114</sup> Section 232 of the Corporations Act 2001.

contrary to the interests of members.<sup>115</sup> The section is wide enough to cover any conduct that is detrimental to any shareholder. For example, it covers derivative actions that might be instituted in respect of affairs being conducted in a manner that is contrary to the interests of the members as a whole.<sup>116</sup> While the section offered relief to shareholders, it was considered to be inadequate because:<sup>117</sup>

“The definition of “affairs of the company” may not include the act of a nominee director to a subsidiary; it may be argued that a resolution of the company in general meeting is not an act by or on behalf of the company; the question of whether conduct can be considered to be unfairly prejudicial or unfairly discriminatory if it affects all members of the same; the fact that applicants for relief are limited to registered shareholders and the ASC [Australian Securities Commission]; the section does not deal specifically with the issue of costs; the standard of proof of shareholders is onerous.”<sup>118</sup>

As a result of the foregoing difficulties, the Companies and Securities Advisory Committee<sup>119</sup> recommended the enactment of a statutory derivative action. As a result, the Corporations Act 2001 provides for a statutory derivative action by enabling:

“A person to bring proceedings on behalf of a company or intervene in any proceedings to which a company is a party for the purposes of taking responsibility on behalf of the

---

<sup>115</sup> The section was derived from the UK legislation which was developed following the recommendations of the Cohen committee. It is now contained in sections 459-461 of the Companies Act 1985.

<sup>116</sup> *Jenkins v Enterprises Gold Mines NL* (1992) 6 ACSR 539.

<sup>117</sup> Companies and Securities Advisory Committee (CASAC), *Report on a Statutory Derivative Action* (July 1993).

<sup>118</sup> Griggs, “Specific Problems with the Oppression Section” (1993) 11 *Companies and Securities Law Journal* 10. Cited in McDonough, “Proposed New Statutory Derivative Action-Does it go Far Enough?” (1996) 8 Bond LR 47 at 53.

<sup>119</sup> *Report on a Statutory Derivative Action* (July 1993).

company for those proceedings or for a particular step in those proceedings.”<sup>120</sup>

The section abolished the right of a person to bring a derivative action on behalf of a company under common law, but required an applicant to seek leave of the court before commencing proceedings.

In spite of the apparent similarities between Australia and New Zealand, their provisions for derivative actions differ. While the right to apply for leave in New Zealand is limited to current shareholders or directors,<sup>121</sup> actions by current or former members of the company or a related body corporate or by an officer or former officer of the company are allowed in Australia.<sup>122</sup> In Australia, persons who are entitled to be registered as members are also allowed to apply for leave.<sup>123</sup> Whilst this provision gives shareholders a suitable avenue to achieve managerial accountability, it raises some difficulties in respect of interpretation of the term “entitled to be registered.” On the one hand, the term could be interpreted to mean a transfer upon which stamp duty has been paid, while on the other it could mean registration of a transfer that has been refused by the directors.<sup>124</sup>

The class of persons covered by the term “members” for the purposes of suing on behalf of the company, where affairs are being conducted in an oppressive manner, was also widened in Nigeria to include “persons who have suffered or are likely to suffer from conduct which is prejudicial to their interests.”<sup>125</sup> Other persons included in the definition of a member include:

- The personal representative of a deceased member.
- Any person to whom shares of a member have been transferred or transmitted by operation of law.
- A director or an officer or former director or officer of the company.
- A creditor of the company.

---

<sup>120</sup> Section 245 A (1).

<sup>121</sup> Section 165 (1) Companies Act 1993 of New Zealand.

<sup>122</sup> Section 236, Corporations Act 2001.

<sup>123</sup> *Ibid.*

<sup>124</sup> McDonough, *op cit* n 118, at 57.

- The proposed Corporate Affairs Commission in a case where the Commission has received any adverse reports on the conduct of affairs of any company as a result of any investigation carried out by it; and any other person who in the discretion of the court, is a proper person."<sup>126</sup>

Whilst it can be argued that allowing a shareholder of a related body corporate to make an application regarding a company in which he has no stake is undesirable,<sup>127</sup> there can be no doubt that there is a need to widen the class of persons that can seek the oppression remedy from the court. Since creditors may also petition the court for winding-up orders on such grounds, they should also be empowered to seek relief under this section. Although it may be argued that such a step would open a floodgate of claims, the assertion can be refuted on the grounds that the courts would be able to strike out frivolous claims at the stage where leave is sought.

The Nigerian position limits shareholders' ability to bring proceedings by requiring them to show that there is a serious question to be tried. A person entitled to be registered or a former officer might find it onerous to garner enough evidence for discharging the burden.<sup>128</sup>

In the UK, section 459 (1) of the Companies Act 1985, which allows a shareholder to bring action if the conduct of directors is unfairly prejudicial, has been considered to be insufficient as it :

"merely paid lip service to the recommendations of the Jenkins Committee<sup>129</sup> by cautiously recognising only two categories of persons who can petition in the case of conduct which is unfairly prejudicial. These are members of the company or a person though not a member to whom shares

---

<sup>125</sup> *Working Papers on the Reform of Nigerian Company Law*, op cit n 37, p 237.

<sup>126</sup> *Ibid* p 247.

<sup>127</sup> McDonough, op cit n 118, 58.

<sup>128</sup> *Ibid*.

<sup>129</sup> The Report of the Company Law Committee, Chaired by Lord Jenkins (1962) Cmnd 1749.

have been transferred or transmitted by operation of the law."<sup>130</sup>

The UK Law Commission has suggested that a member:

"should be able to bring and subsequently maintain a derivative action to enforce any cause of action vested in the company against any person arising out of any breach or threatened breach of duty by any director."<sup>131</sup>

If this proposition were accepted it would abolish the need to demonstrate wrongdoer's control of the shareholders and consideration of the views of the independent minority for an action to be maintained by an individual. Although the Law Commission proposes that only present members of a company should be able to bring a derivative claim on its behalf,<sup>132</sup> the Company Law Review Steering Group has recommended that a member of a subsidiary should be able to bring a derivative claim on behalf of the parent company.<sup>133</sup> The Company Law Review Final Report has also favoured the enactment of a statutory derivative action.<sup>134</sup>

Further, the UK's Law Commission has proposed that:

"A member should be able to maintain proceedings about wrongs done to the company only in exceptional circumstances...shareholders should not be able to involve the company in litigation without good cause. Otherwise the company may be 'killed by kindness', or waste money and management time in dealing with unwarranted proceedings."<sup>135</sup>

---

<sup>130</sup> *Working Papers on the Reform of Nigerian Company Law*, op cit n 37, p 243.

<sup>131</sup> Law Commission, *Shareholders' Remedies*, Consultation Paper No 142, 1996 para 16.1.

<sup>132</sup> *Shareholder Remedies* (Law Com No 246, Cm 3769) London: Stationery Office, 1997).

<sup>133</sup> *Modern Company Law for a Competitive Economy: Developing the Framework* (URN 00/656) (London: DTI, 2000), para 4.133).

<sup>134</sup> Final Report of the Company Law Review Steering Group (London: DTI, 2001) paras 7.33-7.40, 7.46-7.62.

The Commission favours the use of judicial discretion<sup>136</sup> to balance considerations for and against derivative litigation.<sup>137</sup> In granting leave, a court would have to consider all the relevant circumstances and factors.

This approach is also favoured in other common law jurisdictions. For instance, New Zealand's statutory provisions for a derivative action require the courts, in granting leave, to consider the cost of the action against the relief likely to be obtained.<sup>138</sup> This provision, therefore, ensures that New Zealand courts grant leave for a derivative action in cost-effective cases.<sup>139</sup>

Ghana's Companies Act allows proceedings to be instituted by a company or any member.<sup>140</sup> Although Ghana's Act allows shareholders to institute proceedings, the same right is not extended to a shareholder holding non-voting preference shares who is unable to convene or attend a general meeting.<sup>141</sup> However, being a bona fide member, it seems unfair that such a shareholder should be denied similar rights.

To avoid the possibility of a director controlling the resolution of a general meeting to sue, Ghana's Companies Act excludes defendant directors from voting on such a resolution.<sup>142</sup>

Although the Nigerian Law Reform Commission<sup>143</sup> recognised the danger of giving broad rights to members to sue where the company ought to be the proper plaintiff, it recommended the codification of the rule in *Foss v Harbottle* and the

---

<sup>135</sup> Law Commission, op cit n 131, para 14.1.

<sup>136</sup> In exercising its discretion, a court would have to look at the strength of the case, the applicant's good faith, the interests of the company, whether the wrong was ratifiable or had been ratified, the views of any independent organ of the company and the availability of alternative remedies, and probability of success. See PL Davies, op cit n 44, p 677.

<sup>137</sup> Under the Commission's proposals, leave of the court would be required to commence a derivative action under the new principle. See Chapter 15 of Law Commission, op cit n 131.

<sup>138</sup> See Companies Act 1993 (NZ), s 165 (2) (b).

<sup>139</sup> Other factors that merit consideration include; the likelihood of the proceedings succeeding, considering interests of the company, and the applicant's bona fides. See Prince, op cit n 54, at 408.

<sup>140</sup> Professor Gower's Final Report of the Commission of Enquiry into the Working and Administration of the Present Company law in Ghana, 1961 s 210.

<sup>141</sup> *Pavlides v Jensen* [1956] Ch 565.

<sup>142</sup> See Gower's Final Report of the Commission of Enquiry into the Working and Administration of the Present Company law in Ghana, 1961 s 206.

<sup>143</sup> *Working Papers on the Reform of Nigerian Company Law*, op cit n 37, p 237.

broadening<sup>144</sup> of its principles in order to give shareholders more control over directors. The Commission also proposed the adoption of provisions<sup>145</sup> that would control misuse of derivative actions. These provisions provided grounds upon which a court would grant an application for leave to bring a derivative action. They require:

- "(i) That the complainant must have been a shareholder at the time of the misconduct complained of;
- (ii) That the alleged wrongdoers are in control of the company and therefore would not permit the company to sue;
- (iii) That all damages or other compensation are paid to the company;
- (iv) That any settlement shall be subject to the approval of the court."<sup>146</sup>

Since a shareholder who wishes to enforce successfully liability against an errant director must adduce the necessary documentary evidence, it is important to consider the enabling provisions which may help him in obtaining the evidence.

### ***5.3.5 Inspection and Investigation***

Although a shareholder has a right of access to certain documents, such as the company's annual accounts, statutory minutes books and registers,<sup>147</sup> he cannot compel directors to make available to him any other documents, which are not specified in the Act. Where a shareholder is faced with such hindrance, his only recourse is to seek investigation or inspection of the company's affairs. Under the Act, a court may appoint one or more competent inspectors to investigate or inspect the affairs of a company. In the case of a company having a share capital, the application is required to be made by either more than 200 members or of members holding not less than one tenth of the shares issued.<sup>148</sup> In the case of a company not

---

<sup>144</sup> *Daniels v Daniels* [1978] Ch 406.

<sup>145</sup> The provisions were borrowed from the Canadian Business Act 1975.

<sup>146</sup> *Working Papers on the Reform of Nigerian Company Law*, op cit n 37, p 237.

<sup>147</sup> Section 162 (1).

<sup>148</sup> Section 165 (1) (a).



having a share capital, the application ought to be made by more than one-fifth in the number of persons on the company's register of members.<sup>149</sup>

A shareholder who is incapable of mustering the required majority cannot make an application under this section. As a result, he would not be able obtain documentary evidence for the purposes of enforcing directors' liability. As it stands, the provision is too stringent and ought to be relaxed in order to accommodate more investigations. Alternatively, shareholders should be entitled to have access to relevant documents.<sup>150</sup>

Section 170 of the Act gives powers to the Attorney General to institute proceedings on behalf of the company. While this provision might appear to offer effective machinery to circumvent stringent rules against individual suits, a member may still be deterred from proceeding as he is required to provide the registrar of companies with security for costs when he wishes the affairs of the company to be investigated.<sup>151</sup> Given that there is no provision for contingency fees in Kenya, a member who is unable to provide the security for costs would be deterred from pursuing individual suits. To facilitate enforcement claims, the security required prior to investigation should be abolished.<sup>152</sup> However, a member should be required to seek leave of the court before proceeding with an action in order to avoid multiplicity of suits.

#### **5.4 Enforcing Liability in Parastatals**

Parastatals<sup>153</sup> are bodies having a separate legal entity which earn their revenue from the sale of goods and services and the government holds a majority shareholding in them.<sup>154</sup> Most parastatals are charged with the duty of carrying out special governmental functions in the national interest. For this reason, the government

---

<sup>149</sup> Section 165 (1) (a).

<sup>150</sup> *Working Papers on the Reform of Nigerian Company Law*, op cit n 37, p 249.

<sup>151</sup> The security required in Kenya amounts to Kshs 10, 000 (£ 100), which is a substantial sum.

<sup>152</sup> The Nigerian Law Reform Commission also recommended the relaxation of Nigeria's inspection and investigation provisions ( Sections 157-167 of the Nigerian Companies Act 1968) on the grounds that they barred many shareholders from enforcing directors' liability. See *Working Papers on the Reform of Nigerian Company Law*, op cit n 37, p 237.

<sup>153</sup> Parastatals are discussed in detail in Chapter Six.

exercises immense control over parastatals. This control is exerted in various ways. First, there is the control of management and policy which is through ministerial<sup>155</sup> and Parliamentary control. Second, formal and legal control ensures that parastatals conform to legal provisions. Third, there is informal control exerted by public opinion and other bodies dealing with parastatals. Given that the state has a major role to play in controlling parastatals,<sup>156</sup> the judiciary would be expected to play a more active role in their internal management in order to ensure fair dealing.

Unlike the internal control of ordinary companies, which lies either in the general meeting or in the board of directors, as may be specified in the articles of association, the control is radically different in parastatals, as there are no general meetings. To a large extent, the Government performs the functions of a general meeting by, for instance, issuing directives or appointing directors.<sup>157</sup> As such, a Minister may appoint whoever he pleases to the board of directors with no requirements prescribed, except in the case of banks.<sup>158</sup>

Being appointees of either the President or his delegate, board members are more likely to conform to the directives of the appointor. If, for instance, they are directed not to institute any proceedings against a miscreant director they are unlikely to commence proceedings.

Bearing in mind that the Government is often the main shareholder in parastatals, minority shareholders, where they exist, are perpetually oppressed. First, it is difficult to enforce liability in parastatal companies because the Attorney General, being a political appointee, is usually reluctant to commence proceedings against the Government. Second, the restrictions imposed on minority shareholders by the rule

---

<sup>154</sup> SRI International and Mwaniki Associates, *Parastatals in Kenya: Assessment of their Impact and an Action Plan for Reform*; Final Report Prepared for Kenya Association of Manufacturers, February, 1992, p 49.

<sup>155</sup> The State Corporations Act provides that the president shall provide for the management of every public corporation established under the provisions of the Act.

<sup>156</sup> All State Corporations fall under a Ministry. A minister may give directions of general character, as to the exercise and performance by the organisation of its functions in relation to matters appearing to the Minister to affect the national interest. Responsibility of determining what general interest entails is bestowed on the Minister.

<sup>157</sup> James and Ligunya, "Organizational Relationship and the Control of Parastatals in Tanzania", [1972] 5 *East African Law Review* 39, at 45.

<sup>158</sup> *Ibid* at 52.

in *Musa Misango v Eria Musigire & Others*<sup>159</sup> makes it difficult for shareholders to enforce liability. Given that minority shareholders of parastatals are not in a position to exert any kind of control on directors, relaxation of the rule in *Musa Misango v Eria Musigire & Others*<sup>160</sup> would enable courts to intervene more readily in the internal management of parastatals. Reluctance to intervene in the internal management of companies does not augur well for Kenya, as shareholders in parastatals do not have a voice in the disqualification of directors or the termination of their appointments.

## 5.5 Conclusions

The foregoing analysis of the prerequisites for maintaining an action against a director clearly shows that a shareholder's right to enforce liability is minimal. On the understanding that restrictions might prejudice the interests of both the shareholder and the company, it is important at this stage to examine measures that Kenya might adopt so as to enable shareholders to enforce directors' liability without compromising the corporate entity of the companies.

In spite of the commercial need to protect minorities against the oppressive power of the majority, the fact that efficient conduct of business dictates that the majority should prevail in the management of a company's business cannot be ignored. In formulating effective enforcement machinery, there ought to be a reasonable balance of the competing interests. Although excessive regulation or control by the courts would impede efficiency in business conduct, lack of sufficient control or judicial intervention in the internal management of companies would deprive both the minority investors and the company of their rightful profits.

It has been demonstrated above how Kenyan courts apply the rule in *Musa Misango v Eria Musigire & Others*<sup>161</sup> in order to discourage multiplicity of suits and wasted litigation. The position in Kenya requires the decision to sue to be taken by a majority shareholders in a general meeting.<sup>162</sup> The rule has been seen to have the effect of protecting shareholders and creditors in bestowing the decision to litigate,

---

<sup>159</sup> [1966] EA 390.

<sup>160</sup> Ibid.

<sup>161</sup> Ibid.

<sup>162</sup> PL Davies, op cit n 44, p 658.

being a decision to commit company resources, on the general meeting. Besides, all members may not share views of the individual shareholders. Although the rule in *Musa Misango v Eria Musigire & Others*<sup>163</sup> plays the crucial role in preserving the corporate and collective nature of the company, the rule overly restricts individual shareholders' power to enforce company's rights.<sup>164</sup>

It is apparent that a shareholder willing to bring an action against an errant director in Kenya has to contend with numerous hurdles before he can be heard. A derivative action is generally possible only if the applicant can invoke one of the exceptions to the rule in *Musa Misango v Eria Musigire & Others*. While the corporate entity demands that some threshold requirements should be a prerequisite to suing a director, there ought to be less rigid rules prescribing when a single shareholder should have a right to maintain an action on behalf of the company. Given that companies have become the ultimate models of conducting business, exercise of directors' discretion should be subject to more control.<sup>165</sup> Besides, whilst the rule in *Musa Misango v Eria Musigire & Others* protects both shareholders and creditors against frivolous use of company resources by litigious individuals, there is room to argue that it may also encourage errant directors to stifle litigation against them.<sup>166</sup>

The present Kenyan position favours preservation of the collective nature of corporate decision-making rather than enforcement of directors' duties. This makes it difficult for director's duties to be enforced unless there is change of control of the company. This position militates against good corporate governance<sup>167</sup> principles and their enforcement, as shareholders are hindered from pursuing individual suits when necessary.<sup>168</sup> A proper balance, therefore, needs to be struck.

---

<sup>163</sup> [1966] EA 390.

<sup>164</sup> Sealy, "Problems of Standing, Pleading and Proof in Corporate Litigation" in Pettet (ed), *Company Law in Change* (London, 1987). Cited in Davies PL, op cit n 44, p 658.

<sup>165</sup> Bottomley, op cit n 54, at 138.

<sup>166</sup> Prince, op cit n 54, at 496.

<sup>167</sup> "Corporate governance refers to the process and structures used to direct and manage the business and affairs of the corporation with the objective of enhancing long term value for shareholders and the financial viability of the business." See Bidin, "Corporate Law Directors' Duties and Creditor Protection" [1998] 19 Co Law 188, at 189.

<sup>168</sup> Bidin, *ibid*, at 188.

The change of attitude by the courts and their willingness to interfere in the internal management of companies could promote investors' confidence in the management of companies, as they would be assured of the effective monitoring of directorial activities. Similarly, abolition of the need to demonstrate wrongdoer's control of the shareholders for an action to be maintained by an individual would improve the position of minority shareholders in respect of non-ratifiable breaches.

It is apparent that section 211 of the Act is too restrictive as it only allows members to invoke the section when the affairs of the company are conducted in a manner oppressive to some members of the company. It is submitted that adopting a statutory provision that would encompass a wider interpretation would protect shareholders in a more appropriate way. Such a provision should, for instance, encompass conduct that disregards interests of the members. Such measures, which have been adopted in Australia and New Zealand, would clearly neutralise the limitations of the rule in *Musa Misango v Eria Musigire & Others*.

Also, given the difficulties encountered by shareholders who have to prove oppression for a company to be wound up, there is a need to separate the winding-up grounds from the protection of minority shareholders.

In spite of the changing nature of companies' legislation in other jurisdictions, the Act appears to have remained static. The failure of both the Act and the courts to adequately protect shareholders from directors of their companies will continue to adversely affect the well-being of companies and the economy, unless more powers are given to shareholders.

As the wind of change sweeps across Australia and UK as well as other common law jurisdictions,<sup>169</sup> the task of ensuring that Kenya is not abandoned in a bygone era lies squarely on the shoulders of the judiciary and Parliament.

---

<sup>169</sup> Such as New Zealand.

## CHAPTER SIX

### 6.0 THE GOVERNANCE OF PARASTATALS

#### 6.1 Introduction

One of the factors that has contributed to the poor state of the Kenyan economy<sup>1</sup> and the indebtedness of the country to international lending agencies and western countries<sup>2</sup> is the mismanagement of public resources. A vast majority of public enterprises have performed poorly over the years. In fact, parastatals owe a sizeable percentage of all the debts of the country. Their mismanagement has, in some instances, resulted in the insolvency<sup>3</sup> of a number of parastatals. Parastatals are bodies having a separate legal entity which earn their revenue from the sale of goods and services and the government holds a majority shareholding in them.<sup>4</sup> The government exercises immense control over parastatals, as it has powers to appoint directors and issue directives of a general nature.<sup>5</sup> Parastatals are peculiar to most African countries and have no direct parallel in the UK and other developed countries. They were first established in Kenya by the colonial government to provide services that were not provided by the private sector. Parastatals control key sectors such as agricultural exports, transport and communications, manufacturing

---

<sup>1</sup> According to a World Bank report, *World Development Indicators*, released on 30 April 2001, Kenya was the only one of the 10 sub-Saharan countries with negative growth rates greater than 0.5 per cent in 1999. Although the economy of the country grew by 4.2 per cent between 1980 and 1989 and 6.5 per cent between 1970 and 1979, the growth had declined to 2.2 percent by 1993. The GDP slowed down from 2.3 per cent in 1997 to 1.8 per cent in 1998. See Redfern, "World Bank's Dim Picture of Kenya's Economy", *Daily Nation*, 1 May, 2001; "An Economy at War with Itself", *East African Standard*, 25 April, 2001; Magero and Kanani, "Concern over Large Increase in Domestic Debt", *The East African* 10 January, 2000.

<sup>2</sup> A sizeable percentage of all the country's debt is owed by parastatals. See SRI International and Mwaniki Associates, *Parastatals in Kenya: Assessment of their Impact and an Action Plan for Reform; Final Report Prepared for Kenya Association of Manufacturers*, February, 1992, pp 36, 61.

<sup>3</sup> The insolvency of Kenya Co-operative Creameries has been attributed to conflict of directors' interests with those of the company. The directors were involved in making, for instance, irregular purchasing decisions in total disregard of all the rules of competitive tendering. See "Power Games Humble Giant Dairy Company", *Daily Nation*, 20 July, 1999.

<sup>4</sup> SRI International and Mwaniki Associates, op cit n 2, at 49.

<sup>5</sup> Legal Notice No 59 of 25 February, 1987 exempted some parastatals from the State Corporations Act 1987. These included the Kenya Commercial Bank Ltd, the National Bank of Kenya Ltd, the Kenya National Assurance Co Ltd, and the Kenya Re-Insurance Corporation.

and agricultural trade.<sup>6</sup> The poor performance of parastatals and the subsequent insolvency of many of them has left many investors and creditors with heavy losses.<sup>7</sup> For instance, the insolvency of Kenya National Assurance Company led to the loss of millions of shillings by individuals who were insured by the company. In spite of the consequences of parastatal mismanagement on the economy of the country, the government has done little to address the problems affecting the proper governance of parastatals.<sup>8</sup>

It has been 39 years since independence and the system of using parastatals to run important industries established in Kenya during the colonial era, continues to thrive under the same corporate framework.<sup>9</sup> Although parastatals were initially thought to be powerful vehicles for economic development, most have been a drain on the economy. Their products and services are usually exorbitantly priced, of inferior quality, and delivery times are unreliable.<sup>10</sup> To improve their performance, the government has elected to privatise them.<sup>11</sup> The need for privatisation is attributable to the failure of the State, as an owner of enterprises, to motivate the firms to realise competitive business standards.<sup>12</sup> Despite the overall poor performance, parastatals with foreign management<sup>13</sup> and those run by management agents have been relatively successful due, at least, to their independence from the government.<sup>14</sup> For

---

<sup>6</sup> G Barbara, *Public Enterprise in Kenya: What Works, What Doesn't, and Why*, (Colorado, 1991) 1.

<sup>7</sup> Magero and Kanani, "Government Making Efforts to Save KNAC, Says Okemo", *East African Standard*, 3 April, 2001.

<sup>8</sup> Failure by the government to address adequately the problems caused by corruption has made the cost of doing business in Kenya one of the highest in the world. See Nyong'o, "How Bad Governance Strangles Business", *Daily Nation*, 10 June, 2001.

<sup>9</sup> Kenya attained independence in 1963. More than 100 parastatals were created between 1963 and 1978. See SRI International and Mwaniki Associates, op cit n 2, at v.

<sup>10</sup> Ibid p 1.

<sup>11</sup> The government has even privatised some profitable ones, such as Kenya Railways, because of mismanagement of assets and resources. See "KR to go Public, Government Says", *Daily Nation*, 15 March, 2000.

<sup>12</sup> S Estrin, "State Ownership, Corporate Governance, and Privatisation", in OECD, *OECD Proceedings: Corporate Governance, State Owned Enterprises and Privatisation*, (Off Pubns OEEC 2781, 1998), p 11.

<sup>13</sup> Despite General Motors being jointly owned by General Motors, the Kenyan government, and Itochu Corporation (Japan), it has been profitable over the years. General Motors has a 57.7 percent majority equity interest and management responsibility, Itochu Corporation has 4.5 percent equity, and the government of Kenya owns 20.0 percent. See General Motors website <[http://www.gm.com/company/corp\\_info/global\\_locations/kenya.htm](http://www.gm.com/company/corp_info/global_locations/kenya.htm)>

<sup>14</sup> SRI International and Mwaniki Associates, op cit n 2, at 54.

example, despite being a parastatal, Mumias Sugar Company has been profitable due to its management by a professional company, Booker Tate.<sup>15</sup>

The difference in performance between parastatals that are closely linked with the government and the ones that are not, underscores the important role played by an independent board of directors in running a company efficiently. It is against this background that this Chapter seeks to assess the reasons for the good performance of some and the poor performance of others. The Chapter also appraises the historical development of parastatals, the effects of their performance on the economy of Kenya, and the initiatives adopted by the Kenyan government in order to streamline their regulation. This assessment will shed light on the regulation of parastatals and their management and whether there needs to be reform.

## **6.2 Background**

### **6.2.1 Impact of Parastatals on the Kenyan Economy**

In 2000, Kenya had a negative Gross Domestic Product (GDP) growth rate of 2.4 per cent.<sup>16</sup> The poor state of the economy of Kenya has mainly contributed to the country's heavy dependency on international lending agencies.<sup>17</sup> Despite this dependency, the continuous structural adjustment of the extension of credit to the country by the donor agencies, such as the IMF, has had little impact on the economy of Kenya.<sup>18</sup> Increasing internal debts<sup>19</sup> have reduced the creditworthiness

---

<sup>15</sup> In the past the government has unsuccessfully attempted to influence Tate's management decisions relating to appointment and removal of directors, sugar allocations, and the cancellation of the managing agent contract. See Shaw, "Mumias Privatisation and the Bigger Picture", *Daily Nation*, 30 September, 2001.

<sup>16</sup> The only other African countries with negative growth rates were Zimbabwe, Eritrea, and Cote d'Ivoire. Despite the state of insecurity in Sierra Leone, it managed a growth rate of 1.3 percent. Similarly, the GDPs of Tanzania and Uganda grew by 2.7 percent and 2.2 percent respectively. See World Bank Development Report 2002 < <http://www.worldbank.org/wdr2001/> > Also see Redfern, "Tanzania, Uganda Grew as Kenya Shrank", *The East African*, 1 October, 2001.

<sup>17</sup> By 1996, external debt had grown to 77 per cent of the country's GDP. However, by November 2000, Kenya's external debt had increased from £16.2 million at the end of 1998 to £93.6 million. See "An Economy at War with Itself", *East African Standard*, 25 April, 2001; Magero and Kanani, *op cit* n 1.

<sup>18</sup> In 1998, the World Bank's Operations Evaluation Department said only 57 per cent of its projects in Kenya were satisfactory. See "An Economy at War with Itself", *East African Standard*, 25 April, 2001.

<sup>19</sup> "Sacco Petitions State over Sh 600 Million Debt", *Daily Nation*, 8 September, 2001; Kikechi, "TARDA on Verge of Collapse", *East African Standard*, 27 June, 2001.



of the country.<sup>20</sup> In fact, debts owed by parastatals have paralysed operations of some local creditors. For example, Reli Co-operative Savings and Credit Society recently sought the help of the government to recover 591 million Kenyan Shillings (£5.91 million) from Kenya Railways Corporation (a parastatal). Similarly, another parastatal, Tana River and Athi River Development Authority (TARDA), which is on the verge of insolvency, has sought the assistance of the government to recover debts owed to it by another parastatal, Kenya Power and Lighting Company.<sup>21</sup>

Although parastatals accounted for about 11 per cent of GDP between 1986 to 1990, they were responsible for a net outflow of three billion Kenyan shillings (£30m), equivalent to 0.9 per cent GDP in 1991, from the central government. Parastatals also consumed about 17 per cent of the gross fixed investment. In 1990, parastatals owed 17 per cent (£ 633 Million) of the total public debt. Between 1973 and 1986, parastatals accounted for an average of 35 per cent of the total external public debt. As a result of such debts, international lending agencies<sup>22</sup> have been urging the government to privatise parastatals in order to reduce public spending and improve<sup>23</sup> their general performance.<sup>24</sup>

To reverse the deteriorating performance of parastatals, the government, in 1986, sought to increase the role of the private sector in order to foster dynamic economic

---

<sup>20</sup> According to the World Investment Report by the United Nations Conference on Trade and Development (UNCTAD) for the year 2001, the foreign direct investment flows to sub-Saharan Africa decreased from £ 5.6 billion in 1999 to £ 4.6 billion in 2000. See "PS Warns of FDI Outflow", *East African Standard*, September 27, 2001.

<sup>21</sup> Kikechi, op cit n 19.

<sup>22</sup> The World Bank and the IMF are the most influential donor agencies in Kenya. The agencies have been so influential that the IMF played a major role in the drafting of the Constitution of Kenya (Amendment) No 2 Bill, 2001. However, attempts to initiate policy reforms by the agencies have not been so successful. For instance, the liberalisation of the agricultural sector has led to the decline of the sector, as Kenya's produce has not competed effectively with foreign produce. The poor quality of Kenya's produce has been attributed to "unfavourable climatic and ecological conditions, inappropriate technology, poor infrastructure, modest and obsolete equipment, a poor resource base, inadequate research and unfavourable credit conditions." See Keng'ore, "Why We Should be Wary of the World Bank, IMF", *East African Standard*, 1 October, 2001.

<sup>23</sup> Apart from inefficiency of parastatals, other factors contributing to lack of foreign investment in Kenya are: slow pace in privatising parastatals, general bureaucracy, bad infrastructure; crime, and regulatory constraints. Pfizer recently attributed its decision to leave the Kenyan market to poor sales brought on by increasing competition from generic drugs and unfavourable economic regulations. Other companies, which have left, include Johnson and Johnson Ltd, which relocated to Zimbabwe, and Dawa Pharmaceutical. They cited their reasons for leaving as: high power tariffs and electric supply problems, heavy duties on imported raw materials, and a poorly performing economy. It is feared that the departure of established drug companies could lead to an increase in fake generic drugs. See Akoko and Ondego, "Pfizer to Pull Out of Kenya", *Daily Nation*, 6 September, 2001.

growth.<sup>25</sup> The belief that resources are likely to be used more efficiently if they are transferred to the private sector led the government to adopt a privatisation programme.

Although the programme had started with the idea of reducing State spending and enforcing market discipline, investors are still reluctant to conduct business in Kenya. In fact, foreign ventures in Kenya have begun to relocate their enterprise away from the country due to the few prospects of economic improvement.<sup>26</sup> Given that there is a huge demand for limited capital and resources in the world, investors are not likely to be attracted to countries without stable economic and regulatory systems.<sup>27</sup> In order to restore the confidence of investors and foster high economic growth, the IMF<sup>28</sup> has advised the country to implement measures to address problems of governance, the pursuit of macroeconomics policies, and the acceleration of structural reforms.<sup>29</sup> While some measures, such as privatisation, may reduce the intervention of the government in the economy, it is not entirely certain that corporate governance would necessarily improve, since private entities can be as inefficient as state corporations.

### **6.2.2 Development of Parastatals**

As stated earlier, parastatals were first established in Kenya by the colonial government on the understanding that they would be the most appropriate mechanism for providing services that were not provided by the private sector.<sup>30</sup> In addition, it was felt that public enterprises were better placed to curb exploitation of

---

<sup>24</sup> SRI International and Mwaniki Associates, op cit n 2, at 36; Magero and Kanani, op cit n 1.

<sup>25</sup> 1986 Sessional Paper No 1 on Economic Management for Renewed Growth in, "An Economy at War with Itself", *East African Standard*, 25 April, 2001.

<sup>26</sup> According to the United Nations Conference of Trade and Development's (UNCTAD) World Investment Report 2001, Kenya is among the ten countries with the highest rate of foreign direct investment outflows in Africa. The country had an outflow of about £ 56 million in 1999 and 2000. According to the report, South Africa, Angola, Egypt, Nigeria, and Tunisia attracted investment because of: primary extraction, political stability, suitable environment for investment, labour costs, skills, technological advancement, and infrastructure. See Miring'uh, "Foreign Direct Investment to Africa Drops", *East African Standard*, 19 September, 2001. Also see Keng'ore, "Business Firms Wary of Kenya", *Daily Nation*, 25 April, 2001.

<sup>27</sup> Consultative Forum for Corporate Governance in Africa Speech, Monday 30 October 2000, Nairobi, Kenya < [http://www.thecorporatelibrary.com/countries/kenya/consultive\\_forum.htm](http://www.thecorporatelibrary.com/countries/kenya/consultive_forum.htm) >

<sup>28</sup> IMF's relationship with Kenya started when it gave the country finances to purchase the land occupied by colonial settlers in order to resettle Africans. See Keng'ore, op cit n 21.

<sup>29</sup> Ibid.

consumers. Infrastructural services, such as ports, railways, airlines, post and telecommunications, fell into this category. Crop marketing boards were also established by settler farmers with a view to marketing their produce.<sup>31</sup> The majority of them resembled co-operatives to a large extent because they had grower representation on the boards of directors.

Before independence, the colonial government adopted the Swynnerton Plan in order to develop a group of progressive middle-class African farmers. As a result, the marketing boards that existed were reorganised to serve large numbers of smallholders. Additional boards, such as the Cotton Lint and the Seed Marketing Board and the Kenya Tea Development Authority, were created to cater for the expansion.

Given that most Africans were peasant farmers, agricultural workers in settlers' plantations, and workers in the State sector, the government sought to finance their agricultural, commercial, and industrial entrepreneurship through Development Finance Institutions (parastatals). These included: the Agricultural Finance Corporation of Kenya (AFC), the Industrial and Commercial Development Corporation (ICDC), and the Industrial Development Bank (IDB). Although these parastatals were all successful in the 1960s and 1970s, some, such as AFC, started experiencing liquidity problems when politically connected farmers, with large farms, took loans with insufficient collateral and they continuously defaulted on payments.<sup>32</sup>

After independence, the Kenyan government established similar parastatals with the intention of providing services of a monopolistic nature, Africanising the sector, and

---

<sup>30</sup> By 1990, the parastatal sector had 255 firms, which employed 115,000 people. Their wage bill represented 40 per cent of the public sector and 22 per cent of the national wage bill. See SRI International and Mwaniki Associates, *op cit* n 2, at v.

<sup>31</sup> For instance, the Land and Agricultural Board was established in 1931 to provide credit to settler farmers. Other boards included the Agricultural Regulatory and Commodity Boards, which were mainly established in the 1940s and 1950s for the purposes of marketing and regulating their respective markets.

<sup>32</sup> On 20 November 2001 unsecured loans owed to AFC were 2 billion Kenyan Shillings. See "Govt to Write off AFC Debt" *East African Standard*, 20 November 20, 2001; Nyong'o, *op cit* n 8; "Okemo: AFC too Heavily Indebted" *East African Standard*, 25 October, 2001.

redistributing regional income.<sup>33</sup> As such, the growth of parastatals in Kenya can be attributed to economic as well as social and political objectives. Given that there was a shortage of local entrepreneurs with adequate capital and skills at independence, the government considered it necessary to be involved both directly and indirectly in the economy rather than relying on foreign capital. This enabled the government to play the role of entrepreneur through the medium of parastatals. For example, the Kenya Industrial Estate and the Industrial Commercial and Development Corporation were established to assist local entrepreneurs to increase their participation in the industrial sector. The government deemed it necessary to establish more parastatals in order to facilitate development in sectors which were not attractive to private investors. Such sectors often carried higher investment risks or low returns and, therefore, did not attract investors unless the government reduced risks by participating in joint ventures.

After independence, most foreign investors were wary of investing in Kenya due to risks of nationalisation. As a result, they required the government to be a joint partner in most ventures, which the government agreed to so as to attract foreign capital, technology, and management skills.<sup>34</sup>

Although nationalisation of the existing parastatals was not the main objective of the government, most parastatals created after independence assisted in the Africanisation of the economy. The main players were firms that provided credit and technical assistance. Such firms helped Africans to enter commerce. These included: the Kenya National Trading Corporation that helped in development of farms, the Kenya National Trading Corporation Industrial and Commercial

---

<sup>33</sup> By 1980s there were 223 parastatals, which increased to 255 by 1990. They have now (2001) reduced to 207. Of the 255 in 1990, the government had a majority shareholding in 135 and minority shareholding in 120. Parastatals established between 1963 and 1978 included the Development Finance Corporation; the Agricultural Finance Corporation; the Agriculture Development Corporation; the Maize and Produce Board; the Kenya Industrial Estates; the National Bank of Kenya; the Transport Licensing Board; and the Kenya Reinsurance Board. See G Barbara, *Public Enterprise in Kenya: What Works, What Doesn't, and Why*, (Colorado, 1991); SRI International and Mwaniki Associates, op cit, n 2, 4; Omari "Government Pledge on Corruption", *Daily Nation*, 9 March, 2000.

<sup>34</sup> To protect foreign investors, the government enacted the Foreign Investment Act in 1964, which encouraged government shareholding in joint ventures with private partners. See SRI International and Mwaniki Associates, op cit n 2, at 6.

Development Corporation, and the National Construction Corporation that helped local people enter the construction industry.

Since the government pursued a mixed economy strategy which allowed both the public<sup>35</sup> and private<sup>36</sup> sectors to supplement each other, it had a commitment to promote rapid growth, “equitable distribution of incomes, more balanced equitable distribution of industries,<sup>37</sup> creation of employment opportunities, and the need to supply certain goods and services considered essential to the people.”<sup>38</sup> By participating in the economy, the government sought to control various economic sub-sectors by, for instance, conserving the scarce public capital resources and offering services at low costs to consumers and producers. This was done with a view to achieving African socialism goals, seeking to give political equality, social justice, and human dignity to all. However, the difficulty in balancing all the interests prompted the government to issue guidelines outlining how it would implement its policies. It observed thus:

“The most important of these policies is to provide a firm basis for rapid economic growth. Other immediate problems such as Africanisation of the economy, education, unemployment, welfare services, and provincial policies must be handled in ways that will not jeopardise growth. The only permanent solution to all of these problems rests on

---

<sup>35</sup> It was considered essential for the government to participate in the economy in order to create sensitive controls for the proper utilisation of resources. Government participation in the economy was also used as a means of diffusing ownership to the public. This was the case in the large enterprises such as General Motors, Associated Vehicle Assemblers (AVA), Kenya Textile Mills (KTM), Kenya Breweries Ltd and Leyland Motors. See *African Socialism and its Application to Planning in Kenya*, The Sessional Paper No 10 of 1965, 6.

<sup>36</sup> The creation of a private sector with unrestricted rights was considered a danger as it could lead to the division of the society along class lines. To prevent the growth of private monopolies, the government created parastatals dealing with wholesale trade, such as Kenya National Trading Corporation (KNTC) and Uchumi Supermarkets. See *African Socialism and its Application to Planning in Kenya*, The Sessional Paper No 10 of 1965, at 13.

<sup>37</sup> The government got involved in industries that were considered to be fundamental to industrial development. Sectors regarded as fundamental to the economy included: textiles, chemical and pharmaceutical, mining and construction, machinery and equipment, agro-processing, tourism, finance and banking, electricity and water, and transport and communication. Development finance institutions, such as the Development Finance Corporation and the Industrial and Commercial Development Corporation, were earmarked to help in the establishment of basic industries. They were also to offer professional advice as well as financial assistance to African entrepreneurs venturing into commercial enterprises.

<sup>38</sup> SRI International and Mwaniki Associates, op cit n 2, at 7.

rapid growth. If growth is given up in order to reduce unemployment, a growing population will quickly demonstrate how false the policy is; if Africanisation is undertaken at the expense of growth, our reward will be a falling standard of living.”<sup>39</sup>

The government refrained from adopting nationalisation policies because of the fear that the process would impede the creation of new assets, absorb state funds, and contribute to the flight of private capital. It was considered that high growth needed higher capital formation that could not be financed through domestic savings alone. The reasoning being that “when an industry is nationalised, it must be operated efficiently, cover its costs and earn a profit at least equivalent to the taxes paid when operated privately.”<sup>40</sup>

The expansion of parastatals in the 1960s and 1970s illustrates how crucial the parastatal sector was in the development process of the economy. However, their role seems to have changed by the late 1970s and, in turn, the international lending agencies,<sup>41</sup> among other interest groups, started questioning their viability.<sup>42</sup> As a result, Presidential Committees were set up in 1979 and 1982 to investigate the financing of parastatals. The 1982 Committee found considerable flaws and noted:

“Government involvement in commercial ventures has tended to tarnish the image of the government because the parastatals and other ventures which are expected to be viable have not been profitable. Moreover, in some cases, minority share ownership by the government has served to strengthen foreign ownership and control thus leading to some de-Kenyanisation of the economy.”<sup>43</sup>

---

<sup>39</sup> Sessional Paper No 10, “African Socialism and its Application to Planning in Kenya”, Republic of Kenya, 1965, 18. Cited in G Barbara, op cit n 6, at 15.

<sup>40</sup> Ibid.

<sup>41</sup> The agencies include the World Bank and the IMF. The two are usually referred to as the Bretton Woods institutions.

<sup>42</sup> Public enterprises played a positive role in Kenya’s economy from independence until 1978. At independence, parastatals contributed 11.2 per cent of GDP, which reached 14.4 percent in 1971, but subsequently declined until 1977.

<sup>43</sup> Republic of Kenya, *The 1982 Working Party on Government and Expenditure*, 1982, at 42.

### 6.2.3 *Nature of Parastatals*

Presently, parastatals are deeply implicated in most fiscal problems of African governments because of their inefficiency, losses, budgetary burdens, and poor products and services.<sup>44</sup> Occasionally, they achieve non-commercial objectives, which are used as an "excuse for their poor economic performance."<sup>45</sup> Although the international lending agencies have advocated total privatisation of public enterprises,<sup>46</sup> most of the bureaucrats of African governments have proposed alternative measures, such as centralisation.

Due to the economic crisis facing Kenya from the mid 1970s,<sup>47</sup> the country has been dependent on financial assistance from the World Bank and the IMF. To resolve the economic crisis facing the country, these two bodies, in 1980, successfully urged the Kenyan government to adopt structural adjustment programmes, which would reduce government participation in productive activities.<sup>48</sup> Although the government agreed to reduce its participation in the economy, some government intervention was deemed necessary for the purposes of guiding appropriate development of the country. The intervention was preferred in order to ensure a stable, conducive and economic environment for private sector activities and to provide administrative and social services, such as health and water, which the private sector could not readily offer.<sup>49</sup>

### 6.2.4 *Classification of Parastatals*

Parastatals can be divided into four categories, namely:

---

<sup>44</sup> African governments are keen to privatise parastatals because of the losses resulting from their inefficiency. By 1997, the World Bank had documented more than 2700 privatisations in Africa. See Louw, "Making Privatization Work in South Africa", *Economic Reform Today*, Number 2, 1999 < [http://www.cipe.org/ert/e32\\_e32\\_05.php3](http://www.cipe.org/ert/e32_e32_05.php3)>

<sup>45</sup> J Nellis, *Public Enterprises in Sub Saharan Africa*, Washington DC: The World Bank 1986 in G Barbara, *Public Enterprise in Kenya: What Works, What Doesn't, and Why*, (Colorado, 1991), 7.

<sup>46</sup> Louw, op cit n 44.

<sup>47</sup> Despite the government's investment of £1000 million in the parastatal enterprises, the Treasury received only £2.2 million as dividends in the year 1978/79. Although the government had invested in more than 300 enterprises, this amount was paid by only six enterprises. Republic of Kenya, op cit n 43, at 40-41.

<sup>48</sup> The structural adjustment programme was meant to enhance the role of the private sector and market forces, reduce government expenditure and its level of participation in the economy, budget austerity, liberalisation of both domestic and external trade, and exchange rate management reforms. SRI International and Mwaniki Associates, op cit n 2, at 10.

<sup>49</sup> Republic of Kenya, op cit n 43, at 42.

- Utilities: these are monopolies, which have little or no competition from the private sector.<sup>50</sup>
- Regulatory parastatals: these are semi-monopolies with specific roles to play. Such roles may involve the development of a sub-sector, regulation of production and prices,<sup>51</sup> and marketing by the private sector.<sup>52</sup>
- Commercial or industrial parastatals: these engage in active competition with the private sector.
- Development finance parastatals: these facilitate industrial development and the participation of Kenya nationals in the economy. They achieve this objective by providing funds to industrial and commercial concerns.<sup>53</sup>

### 6.2.5 *The Legal Framework*

The majority of commercially oriented parastatals are incorporated under the Companies Act 1962.<sup>54</sup> Others, especially utilities and commercial regulatory bodies, are incorporated under specific enabling legislation.<sup>55</sup> All parastatals, in which the government has controlling equity interests, either directly or through public institutions, are governed by the State Corporations Act 1987.<sup>56</sup> However, the President has the power to exempt a state corporation<sup>57</sup> from any or all of the provisions of the State Corporations Act 1987.<sup>58</sup> Similarly, the nature of business of a parastatal sometimes necessitates its exemption from the provisions of the State

<sup>50</sup> These include Kenya Ports Authority, Kenya Power and Lighting Company, and Kenya Railways.

<sup>51</sup> The Electricity Regulatory Board is endowed with the responsibility of setting of consumer prices for electricity.

<sup>52</sup> The Cotton Board, for instance, regulates the cotton sub-sector. Others include National Cereals and Production Board and the Kenya Meat Commission.

<sup>53</sup> They include Industrial Development Bank Ltd, Industrial and Commercial Development Corporation, and Development Finance Company of Kenya.

<sup>54</sup> The Companies Act 1962 (Revised in 1978) regulates all companies that are formed or registered under the Act. This may include companies that are limited by shares or by guarantee and parastatals that are registered under the Act. On the other hand the State Corporations Act 1987 regulates the parastatals in which the government is the majority shareholder.

<sup>55</sup> These include Kenya Railways, Kenya Airways, Kenya Post and Telecommunication Corporation, and Kenya Ports Authority. Commercial regulatory bodies with specific enabling legislation include; Cotton Board of Kenya; and Kenya Tea Development Authority.

<sup>56</sup> Cap 446, Laws of Kenya. The Act was enacted following the recommendations made by the Report and Recommendations of the (Philip Ndegwa) Committee on Review of Statutory Boards, Republic of Kenya, May 1979, 19, para 81.

<sup>57</sup> The State Corporation Act defines a state corporation as a "body corporate established before or after the commencement of this Act by or under an Act of Parliament or other written law but not a company incorporated under the Companies Act which is not wholly owned or controlled by the government or by a state corporation." See s 29.

<sup>58</sup> Section 29.



Corporations Act 1987.<sup>59</sup> For instance, being involved in financial market dealings may be a reason for exemption, as some measure of confidentiality may be required in order to attract customers who would otherwise be wary of their financial secrets being made public. Although such parastatals are accorded a large measure of autonomy, they are not entirely free from government intervention.

Under the State Corporations Act 1987, a parastatal can be established as either a statutory corporation or a company. Parastatals that are established as statutory corporations are not registered under the Companies Act 1962. However, parastatals that are established as ordinary companies are registered under the Companies Act 1962 and are subject to it to the extent that it does not conflict with the State Corporations Act 1987.

As opposed to a statutory corporation, the division of powers of parastatal companies is similar to that of private companies established under the Companies Act 1962. Parastatal companies have, subject to the provisions of State Corporations Act 1987, all the powers and privileges of a natural person. Their power flows from the statute creating them and the State Corporations Act 1987. Although statutory corporations have all the powers of a natural person, both the statutes establishing them and ministerial directions sometimes limit their powers.

The State Corporations Act 1987<sup>60</sup> vests the power of appointing a board of directors in the President<sup>61</sup> and the Minister.<sup>62</sup> The President is also empowered to "give directions of a general or specific nature to a board with regard to the better exercise and performance of the functions of the state corporation and the board shall give effect to those directions." <sup>63</sup>

---

<sup>59</sup> Legal Notice No 59 of 25 February, 1987 made exemptions on the Kenya Commercial Bank Ltd, the National Bank of Kenya Ltd, the Kenya National Assurance Co Ltd, and the Kenya Re-Insurance Corporation.

<sup>60</sup> Cap 446, Laws of Kenya.

<sup>61</sup> Ibid s 6 (1) (a), the President appoints the chairman.

<sup>62</sup> Ibid s 6 (1) (e), the minister appoints the chief executive officer and other members of the board.

<sup>63</sup> Ibid s 7 (1).

## **6.3 Reasons for Poor Performance**

### **6.3.1 *Supplementing the Private Sector***

One of the reasons for the poor performance of parastatals is the fact that the objective of some parastatals, as set out by the Kenyan government, is to foster private sector activity rather than their own growth. This often results in conflicts of objectives and can be regarded as a source of inefficiency. The need to assist the private sector partly undermines the efficiency and solvency of parastatals, as the need to have high profits is rarely on the agenda of some parastatals.<sup>64</sup> For instance, despite being nearly half-owned by individuals and institutions, Kenya Power and Lighting has continued to perform mandatory social roles, such as the rural electrification programme.<sup>65</sup> Since such parastatals hardly compete with the private sector, they lose the benefits that can accrue from competition. Conversely, the State of Queensland in Australia has recognised the need to allow such competition. Thus, the Hilmer Report on National Competition Policy recommended that:

“Markets within the state must not be unnecessarily distorted. Each GOC (Government Owned Corporation) must whenever possible compete on equal terms with the private sector and to that end any special advantage or disadvantage of the GOC because of its public ownership or its market power must be removed, minimised or at least made apparent. Where a GOC has excessive market power there may be a need for structural reform to increase competition and special monitoring may be necessary to prevent market abuse.”<sup>66</sup>

### **6.3.2 *Appointment of Directors***

The State Corporations Act 1987 gives the President a strong measure of control of appointments. It allows the President to provide for the management of every public

---

<sup>64</sup> G Barbara, op cit n 6, at 16.

<sup>65</sup> On 10 May, 2001, the government owned 55.08 per cent of the company's shares. See "The Paradox of Money Owed KPLC", *Daily Nation*, 20 November, 2001.

corporation established under the State Corporation Act.<sup>67</sup> The President is also empowered to determine the composition of the board of directors.<sup>68</sup>

Generally, a board of directors in a parastatal comprises of:

- Chairman appointed by the President
- Chief executive
- The Permanent Secretary of the parent Ministry
- The Permanent Secretary of the Treasury
- Less than seven other members who are not employees of the state corporation.

Three of these are required to be public officers, appointed by the Minister.

Due to the political nature of appointments, parastatal boards are composed of many directors who are ex-civil servants with little or no private business experience.<sup>69</sup> As the Daily Nation<sup>70</sup> notes:

“In this country, as in the rest of Africa, people seek political power, not to implement programmes or ideologies, but to hand out benefits in the form of jobs and lucrative contracts to their relations and political allies. And, what we call political parties here are institutions, which are bereft of programmes and ideologies. They are mere patronage structures organised by the elite of various ethnic communities for the purposes of capturing state resources for members of their ethnic communities.”<sup>71</sup>

---

<sup>66</sup> McDonough, "Corporate Governance and Government Owned Corporations in Queensland", (1998) 10 *Bond Law Review* 272 at 289.

<sup>67</sup> Section 3.

<sup>68</sup> Section 6 (1) (a).

<sup>69</sup> SRI International and Mwaniki Associates, *op cit* n 2, at 119.

<sup>70</sup> The Daily Nation Newspaper has been very critical of the government. In fact, the government recently attempted to censor the media as a result of the increasing criticism of most of its policies. The Attorney General sought to do this by introducing the Statute Law (Miscellaneous Amendments) Bill 2001, but the bill was withdrawn when it became apparent that even the opposition Members of Parliament would not support it. See Thuku, "MPs Praised over Media Bill", *Daily Nation*, 15 December, 2001; Githo, "MPs to Determine Fate of Kenya Media", *Daily Nation*, 12 December, 2001.

It is notable that research has attributed poor and ineffective management to the appointment criteria, which is based on political influence rather than relevant technical expertise.<sup>72</sup> Commenting on the effects of political appointments on governance of parastatals the Stanford Research Institute (SRI) International observes:

“A notable feature of the parastatals is that the Board Chairman and the Chief Executive are government appointees. The position of the Chief Executive is particularly crucial since he is the technical head of the parastatal. There is a general belief, however, that these appointments are rarely granted on either merit or on a competitive basis. This has had the effect of not only constraining managerial capacity at the parastatal, but also detrimentally affecting the morale of the technically competent staff, further eroding the ability of the parastatal to operate commercially.”<sup>73</sup>

The appointment of directors by the President and the Ministers politicises directorships. The directors, who sometimes serve concurrently as nominated Members of Parliament and Assistant Ministers,<sup>74</sup> act in the interests of their appointors rather than the corporation. From an economic perspective, it is true to say that the performance of directors of parastatals is constrained by the many agency problems that arise from their political appointments. Although the directors are appointed by the State, the State is not the principal because it derives its mandate from the voters. As a result, both the State and the directors are agents of the voters. This makes it difficult for directors to act in the best interests of parastatals because the State sometimes requires them to pursue political interests in order to meet the expectations of a strategic element of the electorate. This explains why ministerial powers are often used to further political motives, such as enhancing the image of a political party. In fact, a Member of Parliament recently told

---

<sup>71</sup> Kiser, “Political Patronage Mother of Graft”, *Daily Nation*, 1 August, 2001.

<sup>72</sup> SRI International and Mwaniki Associates, op cit n 2, at 119.

<sup>73</sup> Ibid, 50.

Parliament that the Kenyan ruling party, KANU, owed the National Bank of Kenya (a parastatal) over 600 million Kenyan Shillings, (£6 million) which the party was not repaying despite the financial crisis of the bank.<sup>75</sup> Prior to this instance, interference in the operations of the National Bank of Kenya by directors who were political appointees had led the Central Bank of Kenya in 2000 to abolish the post of Executive Chairman in finance parastatals.<sup>76</sup>

Irregular appointment of directors has attracted both local and foreign criticism. For instance, the Parliamentary Public Investment Committee in 2000 urged the Attorney General to introduce legislation that would empower Parliament to vet the appointment of parastatal directors.<sup>77</sup> Similarly, the appointment of some three board members to the membership of Electric Regulatory Board was recently challenged by the World Bank for not meeting the requirements of the Electric Power Act. The World Bank was concerned with the fact that the government ignored the autonomy of the board and removed one of the directors who had vowed to run the company in accordance with the Electric Power Act rather than the State Corporations Act 1987.<sup>78</sup>

Given that Kenya adopts subjective standards to assess directors' culpability,<sup>79</sup> the courts are bound to consider the individual circumstances of directors while assessing liability. As such, a vast majority of directors are likely to escape liability for breach of their duties of skill and care. The appointment of qualified persons would enhance the performance of the boards by raising the standard of care expected from directors. Changing the selection criteria would be more effective than enacting legislation to punish non-skilled directors because, as Luoga notes:

---

<sup>74</sup> Kisero, "Privatisation Law is What Kenya Needs", *Daily Nation*, 10 January, 2001.

<sup>75</sup> Teyie, "KANU Owes National Bank over Sh600m", *East African Standard*, 24 October, 2001.

<sup>76</sup> "Banks to Get Rid of Executive Chairmen", *Daily Nation*, March 3, 2000.

<sup>77</sup> Ouma, "Age Limit for the Heads of Parastatals", *East African Standard*, 28 July, 2000.

<sup>78</sup> Prior to this the government had removed and replaced arbitrarily the entire board. See Mohammed, "World Bank Queries Status of ERB", *East African Standard*, 28 July, 2001 and Kisero, "World Bank Rejects Raila's Answer", *Daily Nation*, 31 July, 2001; Kisero, "Rationalise Hiring and Firing in Public Bodies", *Daily Nation*, 16 May, 2001.

<sup>79</sup> *Flagship Carriers Ltd v Imperial Bank Ltd*, High Court Civil Case No 1643 of 1999 (Unreported), Ruling per PJS Hewett.

"It is irresponsible to enact laws which would operate arbitrarily and onerously upon the non-skilled directors where their presence is a reality and institutionalised."<sup>80</sup>

### **6.3.3 Remuneration**

The implementation of the Ndegwa Committee of 1979 saw the setting of maximum salaries for chief executives. As a result of this review, some wage employees, because of union affiliation, were able to earn higher salaries than the lower cadre of managers supervising them. Such discrepancy, coupled with the setting of salaries of top parastatal executives by the Office of the President, contributes to lack of managerial motivation, especially in finance parastatals where competition with the vibrant better-paying private sector is intense.<sup>81</sup>

Additionally, present remuneration is based on a classification system that classifies all parastatals into six categories from A to F. Although the classification is supposed to rank parastatals according to their importance, it is generally believed that the real classification depends on the closeness of the chief executive to the government. Where a chief executive enjoys a particularly good relationship with the government, his parastatal is likely to be given a higher ranking, even when it does not deserve it.<sup>82</sup> Apart from affecting the motivation of directors, low remuneration discourages them from observing strict business ethics.<sup>83</sup>

It is likely that the poor remuneration of parastatal directors affects the performance of parastatals and contributes to their ineffectiveness in general.

### **6.3.4 Lack of Autonomy**

While the Ndegwa Committee of 1979 attributed no responsibility to the central government for the poor financial performance of parastatals, the 1982 Working

---

<sup>80</sup> Luoga, "Duties of Company Directors in Tanzania: The Need for Legislative Reform", [1991] *East African Law Review* 247, at 266.

<sup>81</sup> G Barbara, op cit n 6, at 167.

<sup>82</sup> SRI International and Mwaniki Associates, op cit n 2, at 49.

<sup>83</sup> The research conducted by SRI international and Mwaniki Associates established that the managers of IDB (Industrial Development Bank) felt that their terms of service should have corresponded with that of KCB (Kenya Commercial Bank). Although both firms are parastatals it was not possible for the directors to have equal pay due to categorisation of IDB as a state corporation and the exemption of KCB from the state corporation Act. See SRI International and Mwaniki Associates, op cit n 2, at 50.

Party on Government and Expenditure associated many of the financial problems with central government control. However, it offered only a few suggestions. It particularly castigated the presence of public enterprises in strictly commercial sectors. It observed that in a competitive sector such presence might prejudice the financial stability of parastatals. The Working Party recommended that:

“the Government should not direct a parastatal to carry out policy related activities which might not be financially sound without providing explicit subsidies for those activities.”<sup>84</sup>

The Committee, however, favoured their involvement in sectors serving important social functions. It is worth noting that the attempts made by the Ndegwa Committee and the 1982 Working Party on Government and Expenditure were not very effective in reforming parastatals. This view was supported by 85 percent of the respondents who took part in a survey conducted in 2001 in Nairobi.<sup>85</sup>

Since the board of directors<sup>86</sup> is made responsible for the proper management of the affairs of parastatals, it is accountable for funds and responsible for the financial business and the management of the parastatal.<sup>87</sup> However, unlike private companies, the ultimate internal control of parastatals lies in the government. The government performs the role of the general meeting by appointing directors and issuing directives.<sup>88</sup>

The Inspector of State Corporations plays an important role in the running of parastatals, as he has the duty of advising the government on all matters affecting the effective running of state corporations. He is also obliged to report to the Minister in respect of management practices within any corporation and to report, to

---

<sup>84</sup> Republic of Kenya, op cit n 43, at 42; G Barbara, op cit n 6, at 17.

<sup>85</sup> The results of the survey are discussed in more details in Chapter Nine.

<sup>86</sup> The number and composition of the board varies among parastatals. The number varies from 6 to 16. Although the board of directors has private sector representatives, the management role of private representatives is undermined by the heavy government presence. Section 6 of the State Corporations Act 1987 provides that the number of directors should be eleven of which at least four should be private sector representatives, unless the specific enabling statute provides otherwise.

<sup>87</sup> Section 15 (1) of the State Corporations Act 1987.

<sup>88</sup> James and Ligunya, “Organizational Relationship and the Control of Parastatals in Tanzania”, [1972] 5 *East African Law Review* 39, at 45.

the Controller and Auditor General (Corporations), any cases where moneys appropriated by Parliament are not being applied by the state corporation for the purposes for which they were appropriated.<sup>89</sup> Upon conclusion of investigations, the Inspector has powers to disallow any item of account, which is contrary to the law or to any direction lawfully given to a state corporation. He can also surcharge the amount of any expenditure on the person responsible for incurring the expenditure.<sup>90</sup>

The State Corporations Act 1987 entitles a person aggrieved by the decision of the Inspector to appeal to the State Corporation Appeal Tribunal. The Tribunal may confirm, vary, or quash the decision of the Inspector and subsequently remit the case to the Inspector with such directions as the Tribunal thinks fit. Appeals from Tribunal decisions lie in the High Court.<sup>91</sup> The fairness of decisions arrived at in the Tribunal are questionable, as the Tribunal comprises of a chairman who is appointed by the President and two other members appointed by the Minister.<sup>92</sup>

Since the State Corporations Act 1987 does not impose any limit on the ability of Ministers to direct the board, the board of directors is not able to question or review undesirable directions. Ministers are also not under any obligation to adopt sound corporate governance practices. As such, the position of parastatal directors differs from that of their counterparts in the private sector. For instance, parastatal directors may escape liability for considering the interests of the government rather than those of the corporation or the wider community. With such a structure in place, the governance of parastatals can hardly be appropriate, as directors are more likely to act in the interests of the government.

To reinforce transparency in the exercise of ministerial powers, the State of Queensland in Australia requires the publication of any ministerial decision

---

<sup>89</sup> Section 18 (1).

<sup>90</sup> Section 19 (1).

<sup>91</sup> Section 21 (1) and (2). It is worth noting that the Tribunal has never been constituted since the State Corporations Act 1987 came into force. Similarly, the State Corporation Advisory Committee, which is meant to administer the law, has never been created. See Kisero, "Corporations Act has Outlived its Usefulness", *Daily Nation*, 30 May, 2001.

<sup>92</sup> Although the Law Society of Kenya and the Institute of Certified Public Accountants are required to nominate ministerial appointments, the appointment of the chairman is not subject to such requirements.



affecting Government Owned Corporations (GOCs).<sup>93</sup> The State therefore has an important role to play in the control of GOCs. However, directors of GOCs have the power to make decisions regarding the use of resources. In fact, the corporatisation process has sought to ensure that external controls placed on GOCs are only limited to matters having major strategic issues.

The GOCs are subject to two systems of governance, namely the Westminster political system and aspects of the corporations law. In monitoring GOCs, therefore, Parliament adopts similar checks and balances as it does on the executive and legislature for strategic decisions.<sup>94</sup> This makes the GOCs more accountable than Kenyan parastatals. It is notable that without reinforcing accountability, parastatals can hardly be expected to be profitable. As Hessel notes:

"To run a business enterprise, management must be accorded ample power to manage, but to run it effectively, it must be held accountable for the use of this power."<sup>95</sup>

Although parastatals do not have autonomy, some, such as Kenya Power and Lighting, manage to remain in business due to lack of competition and heavy tariff protection,<sup>96</sup> subsidies, and other special privileges. These privileges, in turn, make it impossible for other companies to compete effectively with parastatals. In fact, most of the seed companies in Kenya are already seeking liberalisation of the seed sector in order to end the monopoly of the Kenya Seed Company.<sup>97</sup>

---

<sup>93</sup> The GOCs share similarities with Kenyan parastatals because they were established to bring about micro-economic reform in the state. In effect, they are meant to improve the "state's overall economic performance and the ability of the government to achieve social objectives through improving the efficiency, effectiveness, and accountability of GOC." See McDonough, op cit n 66, at 305.

<sup>94</sup> See Queensland Treasury Department, *A Green Paper on Government Owned Enterprises* (Queensland Government Printer, Brisbane, August 1990) at 8. Cited in McDonough, op cit n 66, at 289.

<sup>95</sup> Hessel, "How Corporate Governance Makes Privatization Succeed", [1995] 4 *Economic Reform Today* <[www.cipe.org/ert/e18/corp\\_gov.php3](http://www.cipe.org/ert/e18/corp_gov.php3)>

<sup>96</sup> Kenya Power and Lighting Company charges the highest electricity tariffs in Africa. See "Sack all op KPLC Bosses, MPs Urge", *East African Standard*, 6 November, 2001.

<sup>97</sup> Onyinge, "Companies Demand Liberalisation", *Daily Nation*, 20 September, 2001.

### 6.3.5 Overlapping Regulations

Parastatals are subject to overlapping regulations. For instance, although all directors and chief executives of the Communications Commission of Kenya (CCK) are appointees of the Minister under the Kenya Communications Act,<sup>98</sup> CCK is still governed by the State Corporations Act 1987 because it is a state corporation. As such, the President is empowered by the State Corporation Act to appoint the chief executives.

Additionally, parastatals are subject to direct regulation by Parliament. Parliament scrutinises them under the legislation that establishes them. In most cases, the government exercises control of parastatals through Ministers. Since all State Corporations fall under a Ministry, a Minister has powers to give directions of a general character to the organisation. Such directions may, for instance, be in relation to matters appearing to affect the national interest. In such a situation, the Minister has the responsibility of determining what constitutes national interest. Unlike private companies, where a board of directors sets the objectives of the company, the ministers are responsible for identifying such objectives in parastatals. They are bestowed with the responsibility of setting both commercial and non-commercial objectives. The board is accountable to the ministers who are in turn responsible to Parliament. As such, accountability of directors is limited to the financial performance of parastatals.

Additionally, excessive regulations, coupled with extensive ministerial intervention in the functioning of the boards, tend to impair their ability to make commercially sound decisions. Parastatals, including the ones with specific enabling legislation, are required to:

- Report directly to the parent Ministry because the Ministry, in conjunction with the Treasury, must approve parastatal establishment and the remuneration system.<sup>99</sup>
- Obtain budget and investment approval from the Treasury.<sup>100</sup>

---

<sup>98</sup> Section 6 (a) and (b) of the Kenya Communications Act 1998 empowers the President to appoint the chairman and the Minister to appoint the directors. Kenya Communications Act establishes the CCK.

- Justify their accounts before the Public Accounts Committee of Parliament.

Also, parastatals are subject to review by the Parastatal Review Committee, the Auditor General (Corporation)<sup>101</sup>, and the Inspector of State Corporation.

The numerous approval requirements have the overall effect of constraining the ability of directors to make commercial decisions and to recruit and retain skilled staff. Moreover, the expediency of the decision-making process is also rendered ineffective by requirements of ministerial approval. For example, a Minister, in consultation with the Parastatal Review Committee, has to give approval for the employment of a chief executive.<sup>102</sup> The delay in obtaining such approvals is the main causes of the inability of parastatals to make strategic decisions.<sup>103</sup> As such, the process impacts negatively on the general operational performance of parastatals.

The chief executive of a parastatal may be summoned by the Public Investment Committee to answer, on behalf of the board, any question arising from the report submitted to that committee by the Auditor General (Corporations).<sup>104</sup>

### **6.3.5 Fraudulent Transactions**

The interests of directors are more likely to come into conflict with those of parastatals, compared with the normal company situation, because of the excessive control exerted on directors by politicians. Due to this control, directors of parastatals have to take extra precautions to ensure they act in the interests of the company. For instance, duties towards parastatals that are public enterprises are made more onerous because of their involvement in price fixing. For some

---

<sup>99</sup> SRI International and Mwaniki Associates, op cit n 2, at 47.

<sup>100</sup> Borrowing by parastatals must be sanctioned by the Treasury. See SRI International and Mwaniki Associates, op cit n 2, at 48.

<sup>101</sup> Section 17 State Corporations Act 1987, Cap 446 Laws of Kenya.

<sup>102</sup> Also, borrowing of money can only be exercised with the consent of the Minister. Remuneration and reward system at the parastatal must be approved by the Minister, Treasury, Parastatal Review Committee and the Inspectorate of State Corporations. SRI International and Mwaniki Associates, op cit n 2, at 48.

<sup>103</sup> A survey of 12 parastatals conducted in October 1991 indicated that delays in obtaining investment decisions extended to over nine months. In other cases, such as the contentious issue of restructuring parastatals, decision takes more than two years. See SRI International and Mwaniki Associates, op cit n 2, at 49.

<sup>104</sup> Section 30 A (6).

commodities, prices are kept artificially low either to counter inflation or to make some necessities affordable to consumers. Conversely, prices are set by others to protect "inefficient enterprises or provide resources for cross-subsidisation."<sup>105</sup>

Most of the problems identified by the Ndegwa Committee continue to affect parastatals. For instance, the Parliamentary Public Investment Committee in August 2001 revealed how directors of the National Social Security Fund abdicated their duties and, in turn, irregularly awarded themselves executive treats. As a result, the parastatal lost three billion Kenyan Shillings (£30 million) between 1996 and 1998. Similarly, the Kenya Ports Authority paid allowances to board members above the approved rates. Instead of the approved 1000 Kenyan Shillings (£10) per session, board members were paid between 5000 to 10,000 Kenyan shillings (£ 50-100) per sitting.<sup>106</sup>

In addition, the Inspector of State Corporations declared the National Housing Corporation (NHC) technically insolvent because of mismanagement. The directors had commissioned real estate projects worth 319 million Kenyan Shillings (£3.19m) without competitive bidding or getting the approval of the NHC board of directors. It also lost 69 million Kenyan Shillings (£690,000) through deposits placed in the collapsed Prudential Bank by the managing director, disregarding the protests by the finance director, and the Treasury's directive, requiring all surplus funds in parastatals to be invested in Treasury Bills and Bonds.<sup>107</sup>

### ***6.3.7 Conditions imposed by International Lending Agencies***

The privatisation programme has also contributed to the collapse of many parastatals. The structural adjustment loans offered by donor agencies have sometimes expressly obliged governments to privatise parastatals.<sup>108</sup> Failure to comply with the donor conditions results in withdrawal of aid and loans. The use of

---

<sup>105</sup>G Barbara, op cit n 6, at 8.

<sup>106</sup> Gicheru, "MPs Watchdog Finds More State Looting", *Daily Nation*, 16 August, 2001.

<sup>107</sup> Wachira, "NHC Insolvent, Top Official Warns Government", *East African Standard*, 27 April, 2000.

<sup>108</sup> Privatisation was prescribed as a condition in 74 World Bank loans during 1980 to 1989. See Paliwala, "Privatisation in Developing Countries: The Governance Issue", [2000] 1 *Law, Social Justice & Global Development Journal (LGD)* 2 <<http://elj.warwick.ac.uk/global/issue/2000-1/paliwala.html>>; Killick, "The Role of the Public Sector in the Industrialisation of African

such conditions is clearly illustrated by the comments made in 1985 by the then US Secretary of State, George Schultz, when obliging USAID officials to raise certain issues with Less Developed Countries:

"Policy dialogue should be used to encourage LDCs to follow free market principles and to move away from government intervention in the economy....to the maximum extent practical governments should rely on the market mechanism-on private enterprise and market forces...parastatals are generally an inefficient way of doing business...in most cases, public sector firms should be privatised."<sup>109</sup>

Similarly, while announcing resumption of assistance to Kenya on 27 July 2000, the IMF board set tough new conditions, which Kenya accepted as part of the aid agreement. The conditions, which are likely to be politically unpopular,<sup>110</sup> included:<sup>111</sup>

- Introduction of a law binding public officials to declare their wealth and liabilities.
- Weekly inspection of the Central Bank balance sheet by Fund officials in Washington.
- Removing supervision of Ministry spending from permanent secretaries to finance officers
- Shifting district Treasury Officers from the President's Office to the Treasury

---

Developing Countries", *Industry and Development* No 7 (1983), 1467. Cited in G Barbara, *Public Enterprise in Kenya: What Works, What Doesn't, and Why*, (Colorado, 1991), 9.

<sup>109</sup> Killick, *Ibid*.

<sup>110</sup> In November 2001 Members of Parliament were outraged when they learnt that the World Bank had forced the government into contracting specific procurement agents, namely Crown Agents and GTZ. Kenya's Finance Minister also lamented that donor conditions have done little to improve peoples' living standards. See "World Bank Pushed Govt into Hiring Agents", *East African Standard*, 21 November, 2001; Mburu, "Regional Meeting Criticises Donor Conditions", *The East African*, 29 October, 2001.

<sup>111</sup> By agreeing to the conditions, the government has been criticised for selling "away the country's sovereignty for a song." See, "Did We Sell Our Soul to Get Aid from the IMF?" *Daily Nation*, 3 August, 2000.

- Enacting an Anti-Corruption and Economic Crimes Bill.
- Submitting to Parliament, by June 30, 2001, audited public accounts for fiscal years 1998/99 and 1999/2000.
- Offering for sale to a strategic investor 26 per cent of the shares of the Kenya Commercial Bank (parastatal) by September 30, 2000.
- Sending financial information to the IMF's Africa Department, including the Central Bank of Kenya's daily balance sheet.
- Submitting records on new external borrowing and loan guarantees to the Fund within three weeks of the end of each month.
- Giving the IMF every month details of its Treasury bill operations, including arrears on repayments and the size of stock.
- Making available monthly figures on domestic financing of the Budget, implementation of the development budget, with detailed information on the sources of financing, and monthly statistics on external debt repayments.
- Seeking approval of the Fund and World Bank before any new project is introduced during the current financial year.<sup>112</sup>

Before these conditions were imposed, the IMF had been prompted to suspend financial aid to Kenya in July 1997 as a result of the government's failure to act on high-level corruption and follow key governance criteria.<sup>113</sup> The suspension of aid influenced the decisions of other donors to withdraw their aid and, in turn, resulted in an increase of interest rates and foreign investors avoiding doing business in Kenya.<sup>114</sup>

Since the pressure to privatise prompts IMF and World Bank to offer loans with restraints on the public budget,<sup>115</sup> the resultant limitation of public budget reduces public investment which, in turn, contributes to the indebtedness of government to parastatals.

---

<sup>112</sup> Kenya was granted a three-year loan amounting to £ 139 million (Sh14.6 billion or £ 146 million). See Kiseru, "IMF Sets Tough Terms for Kenya", *Daily Nation*, 31 July, 2000.

<sup>113</sup> The government of Netherlands also stopped funding environmental projects in Kenya when Parliament rejected the Kenya Anti-Corruption Authority Bill. See Wanyonyi, "Netherlands Stops Funding for Kenyan Projects", *East African Standard*, 19 September, 2001.

<sup>114</sup> Akumu, "How IMF Will Pump in Funds", *Daily Nation*, 29 July, 2000.

#### 6.4 Parastatal Policy Reform

Since a proper structure to the board of directors is key to appropriate corporate governance, lack of autonomy in the boards of directors impacts negatively on their effectiveness. To assess how effective the parastatal boards are in discharging their responsibilities, it is important to consider what the functions of an effective board ought to be. According to Rogers CJ and, on appeal, the New South Wales Court of Appeal in *AWA Ltd v Daniels*, a board ought to:

“Set the goals of the corporation; appoint the chief executive of the corporation; oversee the plans of managers for the acquisition and organisation of financial and human resources towards attainment of the corporation’s goals; review at reasonable intervals the corporation’s progress towards attaining its goals.”<sup>116</sup>

Similarly, the Capital Markets Authority of Kenya recognises the following set of responsibilities as the most suitable for a board of directors:

- Define the company’s mission, its strategy, goals, plans and objectives including approval of its annual budgets;
- Oversee the corporate management and operations, management accounts and review corporate performance and strategies at least on a quarterly basis;
- Identify the corporate business opportunities as well as principal risks in its operating environment including the implementation of appropriate measures to manage such risks or anticipated changes impacting on the corporate business;
- Develop appropriate staffing and remuneration policy, including the appointment of chief executive and the

---

<sup>115</sup> Zulu, and Nsouli, "Adjustment Programs in Africa", Washington, DC: International Monetary Fund, April 1985. Cited in G Barbara, *Public Enterprise in Kenya: What Works, What Doesn't, and Why*, (Colorado, 1991), 8.

<sup>116</sup> (1992) 10 ACLC 933 at 1013 per Rogers CJ; *Daniels & Ors v AWA Ltd* (1995) 13 ACLC 299 at 662 per Clarke and Sheller JJA.

senior staff, particularly the finance director, operations director and the company secretary as may be applicable;  
Review, on a regular basis, the adequacy and integrity of the company's internal control and management information systems including compliance with applicable laws, regulations, rules and guidelines;  
Establish and implement a system that provides necessary information to the shareholders including shareholder communication policy for the company.<sup>117</sup>

With these functions in mind, it can be seen that the boards of directors in Kenya are not responsible for setting parastatals' goals, as the function is the responsibility of ministers. Given that the chief executives are appointed by the President, the President, rather than the board, has the power to hire and fire. The inability of the board to do so renders the task of imposing performance levels and sanctions difficult.<sup>118</sup> Similarly, the lack of powers to impose sanctions on the chief executive and other senior executives limits the ability of parastatals to meet their goals.

Directors of parastatals are not able to perform efficiently because the government, rather than the directors, ought to comply with good corporate governance practices. As a result it is true to say that "directors are appointed to a position that carries with it all of the liabilities but are not given the power to carry out the roles that the law imposes."<sup>119</sup>

This clearly shows the difficulty faced by directors of parastatals when performing their duties. The overall inability of directors to perform efficiently leads to lax cost control, poor quality and outdated financial accounts, inadequate management information systems, and insufficient plant management and quality control.<sup>120</sup>

---

<sup>117</sup> Capital Markets Authority Corporate Governance Practices for Public Listed Companies in Kenya, Guidelines, December 2000.

<sup>118</sup> World Bank, *Bureaucrats in Business; The Economics and Politics of Government Ownership*, Washington DC 1995 at 14. Cited in McDonough, op cit n 66, at 309.

<sup>119</sup> McDonough, op cit n 66, at 310.

<sup>120</sup> SRI International and Mwaniki Associates, op cit n 2, at 73.



In general, regulation of parastatal directors can hardly be as efficient as that of the private sector due to government's intervention. While public companies have shareholders<sup>121</sup> that can buy and sell shares, and monitor the activities of a company, ownership of parastatals by the general public is rendered virtually compulsory by payment of taxes which, partly, finance the operations of parastatals. Therefore, since the wider community does not buy or sell shares as a reaction to the effectiveness of management, they can only exercise indirect control of parastatals through the ballot box at a general election.<sup>122</sup> Apart from the inability of shareholders to scrutinise parastatals due to lack of trading in their equity, other factors that deprive parastatals of the vital scrutiny by shareholders include the inability of shareholders to remove directors of parastatals and lack of analysis of operations of parastatals by external analysts, such as stockbrokers.<sup>123</sup>

#### ***6.4.1 Steps initiated by the Government***

Although past government policy statements<sup>124</sup> have emphasised the need to reform the parastatal sector, the government did little towards this end until 1985 when it established the office of the Auditor General (Corporations) in order to tighten the control of the financial resources of parastatals by reviewing the enterprises speedily. Similarly, the government sought to enhance investigative and supervisory powers of the Inspectorate of State Corporations Advisory Committee by passing the State Corporation Act in 1986. The State Corporations Act 1987 sought to permit parastatal directors to make independent decisions, to hire staff and chief executives, and to determine their wage rates.<sup>125</sup>

As a result of the success of the privatisation programmes in other countries, the government, in 1991, sought to privatise the commercial parastatals, close down the non-viable ones and reform or restructure the essential utilities and strategic parastatals. At this time, privatisation of public utilities had been successfully

---

<sup>121</sup> 'Property rights' theorists attribute the poor performance of parastatals to lack of individual stake in the assets of the enterprises. See Paliwala, op cit n 108, at 2.

<sup>122</sup> McDonough, op cit n 66, at 294.

<sup>123</sup> Ibid, at 288.

<sup>124</sup> Report and Recommendations of the (Philip Ndegwa) Committee on Review of Statutory Boards, Republic of Kenya, May 1979 and Republic of Kenya, op cit n 43, at 42.

<sup>125</sup> Other institutions established to facilitate reform included the Parastatal Review Committee which was established in 1980s to review the performance and problems affecting all the parastatals in the country.

carried out in other countries, such as the UK government under Mrs Thatcher.<sup>126</sup> Apart from increasing efficiency, privatisation in the UK attracted public interest in state corporations.<sup>127</sup> It is notable that 91 per cent of the respondents who took part in a survey conducted in 2001 in Nairobi took the view that privatisation of parastatals in Kenya would improve accountability.

Whilst this measure may partly reduce the adverse impact on the economy, it is doubtful whether privatisation is the only appropriate step for Kenya to take, given that management and operational constraints are not the only factors affecting parastatals.<sup>128</sup> Besides, without effective regulation of directors, private enterprises can be equally inefficient.

Past attempts to reform parastatals in Kenya emphasised the strengthening of control mechanisms. For instance, in 1992, following negotiations with the World Bank the Minister for Finance attempted to introduce in Parliament three Bills, which would have allowed the Treasury to take over control of parastatals from the Office of the President. The Treasury was meant to exercise its powers in parastatals as a shareholder, delegating powers to the directors in order for the corporate structure to be similar to that of the private sector. They also sought to curb the excessive powers of the State Corporations Act 1987 by abolishing the office of the Inspectorate of State Corporations. However, the government rejected the Bills before they were debated in Parliament, as they undermined presidential powers to appoint directors.<sup>129</sup>

Recent attempts to enhance the performance of parastatals have favoured privatisation. The government has sought to implement a comprehensive parastatal reform programme, which includes the privatisation of all non-strategic parastatal

---

<sup>126</sup> After the commencement of privatisation, the management of state owned enterprises improved and as a result accounted for 11 percent of Britain's GDP. Much of the public enterprise out-put came from state enterprises in telecommunications, gas, electricity, water, rail transport, and postal services. SRI International and Mwaniki Associates, op cit n 2, at 73.

<sup>127</sup> After Amersham International was offered for sale in 1982, it subsequently made a pre-tax profit of £22 million in 1987.

<sup>128</sup> G Barbara, op cit n 6, at 8.

<sup>129</sup> "Leakey Rejects Plea to Exempt Telkom from Act", *Daily Nation*, 12 September, 2000; Kisero, op cit n 91.

enterprises and the rehabilitation and reform of all strategic enterprises.<sup>130</sup> The objectives behind the reform programme include:

- Reduction of the financial and administrative burden that parastatals impose on the government.
- Increasing efficiency through an improvement of the enabling environment for the private sector.
- Raising government revenue from privatisation sales and liquidations.
- Eliminating preferential treatment to allow a level playing field for the private sector.<sup>131</sup>

#### **6.4.2 Privatisation Bottlenecks**

Although the poor performance of parastatals, coupled with pressure exerted by the donor community and the Kenyan private sector to have parastatals privatised, has increased, it might take a long time to finalise the process of privatisation due to constraints, such as: the reluctance of the government<sup>132</sup> to sell or give up profitable enterprises,<sup>133</sup> placing a high priority on unprofitable parastatals which do not attract buyers, opposition from employees arising from fear of retrenchment, intellectual ideologies against privatisation, a narrow field of qualified buyers, lack of developed capital markets,<sup>134</sup> lack of necessary expertise<sup>135</sup> to support the process, lack of

---

<sup>130</sup> The 1982 Working Party on Government and Expenditure had recommended the privatisation of parastatals, which could be well handled by the private sector, and the liquidation of non-viable ones. See Republic of Kenya, op cit n 43, at 42.

<sup>131</sup> Government of Kenya, *Kenya's Parastatal Reform Programme*, A document presented for discussion to the Consultative Group Meeting of Kenya's donors in Paris, November 1991.

<sup>132</sup> By 1991, the Parastatal Reform Policy Committee had made the decision to privatise 139 non-strategic parastatals. A survey conducted by SRI international on privatisation plans indicated that the manufacturing company executives were supportive of the privatisation plans. Some of them, however, doubted whether the government was committed to implementing the reforms fully. See SRI International and Mwaniki Associates, op cit n 2, at 69.

<sup>133</sup> The Nairobi Stock Exchange Chief Executive, Kibuga Kariithi, recently attributed the delay in the privatisation of Telkom and Mumias companies to lack of political will. See Mogusu, "Privatisation Delays Due to Lack of Political Will-NSE", *East African Standard*, 11 September, 2001.

<sup>134</sup> Donald, "Privatization: Persuading a Skeptical Public", Center for International Private Enterprise Publication, 2000 <[www.cipe.org/ert/e08/2across.php3](http://www.cipe.org/ert/e08/2across.php3)>

<sup>135</sup> The government, in 2000, virtually scrapped the key unit, Executive Secretariat and Technical Unit (ESTU), which used to regulate the parastatal reform programme in Kenya. The unit is now comprised of only two people. It was scrapped as a result of donor pressure. Most of the donors to the country preferred to have advisers from the World Bank rather than local ones. As a result of lack of expertise, some institutions, such as Mumias Sugar Company, Chemilil Sugar Company, and the Kenya Reinsurance Corporation, have managed their own privatisation. See "Government Scraps Reform Body", *Daily Nation*, September 26, 2000.

transparency in the divestiture programme,<sup>136</sup> lack of legislation to govern the process,<sup>137</sup> and an uncertain investment climate.<sup>138</sup> Also, parastatals set up as mixed joint stock companies in Kenya contain certain restrictions about the transferability of all or certain classes of shares and provide pre-emptive rights to existing shareholders, which have to be complied with.<sup>139</sup> These are clear indications that the existence of parastatals in the Kenyan market might continue.

It is therefore possible for miscreant directors to continue benefiting from parastatals due to lack of adequate safeguards to cater for the privatisation process. At the moment, there is no law to deal with sensitive privatisation issues, such as: valuation of parastatals, procedure for selecting buyers, use of specific sale techniques, financing of share purchases, and the allocation of privatisation process.<sup>140</sup> As such, there is nothing to prohibit concentration of ownership of privatised state assets in the hands of well connected individuals and multinational corporations.<sup>141</sup> For example, a recent acquisition of East Kenya Bottlers by a South African company, Coca Cola Sabco, and the plans to acquire two other companies were recently criticised by the President for giving Coca Cola Sabco a 70 per cent stake in the entire carbonated soft drinks market contrary to the monopoly laws.<sup>142</sup>

As the current programme stands, it is not possible to safeguard shareholders' and employees' rights to buy shares in parastatals because the entire programme is manipulated<sup>143</sup> by politicians. Illustrative of the manipulation is the free take over of National Milling Corporation by the Premier Flour Mills of Nakuru; the selling of Kericho Tea Hotel to Ms Sololo Investments for a paltry 15 million Kenya shillings

---

<sup>136</sup> "Yes, Privatisation Must be Speeded Up", *Daily Nation*, 19 October, 2000.

<sup>137</sup> Omari, "Government Pledge on Corruption", *Daily Nation*, 9 March, 2000.

<sup>138</sup> Kipkorir, "Making the Most Out of Privatization", in Centre for International Private Enterprise, "Promoting Economic Reform in Africa", <[www.cipe.org/ert/e04/7africa.php3](http://www.cipe.org/ert/e04/7africa.php3)>

<sup>139</sup> Section 74 (1) of the Act provides that holders of not less in the aggregate than fifteen per cent of the issued shares of a special class of shares may apply to court to have the variation cancelled, if they did not consent to or vote in favour of the resolution of variation.

<sup>140</sup> "Transparency Required in the Privatisation of the Sugar Industry", *East African Standard*, 16 October, 2001.

<sup>141</sup> Few indigenous Kenyans have bought the privatised firms to date. See Ngotezi, "Parastatal Bosses are Political Retirees", *The East African*, 24 April, 2000.

<sup>142</sup> "Okemo, Kijirah in Dilemma", *East African Standard*, 4 September, 2001.

<sup>143</sup> When the privatisation programme started in 1992, the Government issued some guidelines to guide the process, but politicians manipulated them, as the guidelines did not have the force of law. See Kiseru, op cit n 74.

(£150,000) ; and the selling to politicians of Golf Hotel of Kakamega, Kisumu Sunset Hotel, Homa Bay Hotel, and Marsabit Hotel,<sup>144</sup>

Even the utilities, which are likely to be retained in the long run because they are profitable will still have a sizeable amount of shares owned by the government.

#### **6.4.3 *Private Sector versus Parastatals***

Corporate governance in the private sector differs significantly with that of parastatals. In the private sector, sanctions and incentives are used to make directors perform their duties with a view to maximising profits. For instance, the market for shares is a sanction used against directors in the sense that shareholders can sell their shares if they are dissatisfied with the management. Outside shareholders also provide a sanction against directors because directors may be dismissed in the event that a lower share price may lead to a take-over.<sup>145</sup> In addition, the threat of insolvency might discipline directors because such a threat may provide incentives for directors to manage the business of a company prudently and, in turn, this will safeguard their reputation and jobs. Moreover, the efficiency of a company may be promoted by rewarding directors with handsome remuneration when their performance is sound.

Although some of the above sanctions may be effective in some instances, some have limitations. For instance, despite the possibility of transferring shares by shareholders when they are dissatisfied with the performance of the management, a transfer of shares would not be effective if the amount of shares transferred is not substantial. Besides, it might be difficult and costly for shareholders to collect the necessary information that would enable them to convince other shareholders concerning the failings of the entity. Undoubtedly, in the event of such limitation the prospects of deterring pursuit of personal objectives by the management would be minimal.

The state, as the principal shareholder, contracts with the management to run parastatals. From an economic perspective, it can be argued that weaknesses in the

---

<sup>144</sup> Kisero, Ibid.

<sup>145</sup> S Estrin, op cit n 12, p 14.

governance of parastatals arise as a result of lack of sufficient market incentives and disciplines. Unlike the private sector, the public sector does not have a market for shares which provides sanctions against poorly performing management. As such, shareholders in parastatals have no exit options. Given that the market for corporate control is absent, the parastatal is never under the threat of take-over and the board under the threat of replacement. This contributes to the poor performance of the board of directors due to lack of incentives to perform effectively. In addition, since parastatals are often bailed out by the State, it can be argued that the lack of the threat of insolvency also contributes to weak governance.<sup>146</sup> This problem is compounded further by the fact that civil servants are not rewarded as a result of improved performance. Lack of economic motivation can thus be a major factor contributing to inefficiency.

Whilst the private sector has a single principal and agent, namely the shareholders and the managers, there are multiple agents in parastatals. Since the State derives its mandate from the voters, the State and the board of directors are both agents of the voters. Serious agency problems arise as a result of this complexity.<sup>147</sup> For instance, given that politicians are accountable to voters they are likely to lose sight of the commercial goals of a parastatal whilst attempting to please strategic parts of the electorate. The economic efficiency of parastatals is also undermined by the fact that the politicians do not have personal equity stake in the entities. As a result, they have no financial incentive to ensure parastatals are managed effectively.<sup>148</sup>

Due to the fact that public enterprises adopt political settings, it is generally believed that the public nature of parastatals makes them inherently inefficient and unprofitable due to inefficient controls.<sup>149</sup> As a result, there is a popular belief that privatisation is a panacea for their inherent problems. McDonough illustrates the undesirable nature of a state corporation as a medium for improving a state's economic performance thus:

---

<sup>146</sup> OECD, *OECD Proceedings: Corporate Governance, State Owned Enterprises and Privatisation*, (Off Pubns OEEC 2781, 1998), p 8.

<sup>147</sup> J Brumby and M Hyndman, "State Owned Enterprise Governance: Focus of Economic Efficiency", in OECD, *OECD Proceedings: Corporate Governance, State Owned Enterprises and Privatisation*, (Off Pubns OEEC 2781, 1998), p 33.

<sup>148</sup> Ibid, p 31.

“By creating a hybrid company/statutory corporation the government has left open the issue of corporate governance. The model does not allow for the directors to act, as they should, as fiduciaries of the organisation that they are appointed to direct. Adopting the corporate structure in the context of GOCs should mean embracing and applying it within a government context with all its imperfections.”<sup>150</sup>

The failure to adhere to effective corporate governance can largely be attributed to the present state of parastatals. Parastatal banks, until very recently, have remained profitable and efficient despite the presence of competing local and multinational banks and their success can be attributed to being subject to less influence from the Ministry of Finance, as ministerial influence has made the business sector so wary of government's involvement in business. As such, government's attempts to regulate business are being rejected. For instance, the attempt to introduce a Bill in Parliament that would empower a parastatal, the Horticultural Crops Development Authority, to regulate<sup>151</sup> the horticultural sector<sup>152</sup> has been opposed by the Fresh Produce Exporters Association of Kenya. The Association claimed that sufficient regulation is already being carried out by the private sector and that the involvement of government would result in inefficiency, which has been witnessed in other sectors regulated by the government, such as tea and coffee.<sup>153</sup>

Apart from the good past performance of parastatal banks, agricultural parastatals also performed well for two decades after independence. Being large and complex

---

<sup>149</sup> Y Aharoni, *The Evolution and Management of State-Owned Enterprises*, (Cambridge, Mass., 1986), Chapter 5.

<sup>150</sup> McDonough, op cit n 66, at 310.

<sup>151</sup> Similar attempts to create an additional parastatal to manage rural electrification was opposed by Kenya Association of Manufacturers because it would have increased production costs of electricity and, in turn, increase electricity tariffs. See Njuguna, “KAM Opposes New Electricity Company Plan”, *Daily Nation*, 10 September, 2001.

<sup>152</sup> The horticultural sector is the second highest foreign exchange earner in Kenya. Flowers, fruits and vegetable exports earned 14 billion Kenyan Shillings in 2000. See Akumu, “Industry Says No to New Law”, *Daily Nation*, 7 September, 2001.

<sup>153</sup> Ibid. Also see Nyambala, “FPEAK Rejects Proposed Levy”, *East African Standard*, 29 September, 2001.

organisations they served large numbers of smallholder farmers.<sup>154</sup> Although privatising public utilities might amount to exploitation of the public interest, which is often guaranteed by parastatals, it can be argued that the floatation of shares might help ailing parastatals to boost their efficiency and profitability by raising capital and creating an interest group that would demand transparency and accountability. The adoption of this strategy has enabled Kenya Power and Lighting Company to remain profitable for a long time.<sup>155</sup> Since some parastatals appear to have failed as a result of subsidising some class of producers and consumers, they would have to stop subsidising such groups for their performance to improve.<sup>156</sup> This being the case, the resultant improvement can be attributed to policy reform rather than privatisation per se. It remains true, that such policy reform is achievable even without privatisation.<sup>157</sup> Although, the privatisation of some parastatals has enhanced their performance,<sup>158</sup> privatisation can hardly be said to be an end in itself, as private monopolies have the capacity of being as inefficient as parastatals in the absence of a strict regulatory framework. For instance, the failure to plan effectively before the liberalisation of the Kenya economy has affected some sectors, such as agriculture. Farmers have attributed the decline in rice production in the country to the unplanned take-over of the government schemes. As the Provincial Commissioner of Central Province stated recently:

“Kenya has managed to liberalise policy but not practice. When we were under the controlled system, it was easy to blame the government. Under liberalisation, there is no one to blame”<sup>159</sup>

---

<sup>154</sup> G Barbara, op cit n 6, at 54.

<sup>155</sup> The company is, however, experiencing liquidity plans and the government has proposed to bail it out. Although the Minister for Energy maintains that the liquidity problems are not as a result of mismanagement, opposition Members of Parliament have opposed initiatives to save the company. Most of the companies' debts were accrued before it was exempted from the State Corporations Act 1987. In November 2001, the government and related organs owed the company 3.1 billion Kenyan shillings. See "Sack All Top KPLC Bosses, MPs Urge", *East African Standard*, 6 November, 2001; "The Paradox of Money Owed to KPLC", *Daily Nation*, 20 November, 2001; G Barbara, *Public Enterprise in Kenya: What Works, What Doesn't, and Why*, (Colorado, 1991), 166.

<sup>156</sup> G Barbara, op cit n 6, at 166.

<sup>157</sup> Ibid.

<sup>158</sup> The privatisation of Kenya Airways has transformed it from a loss making parastatal to a profitable one. See Mogusu, op cit n 133.

<sup>159</sup> "Free Market Stabilises Agriculture, Asserts PC", *Daily Nation*, 25 September, 2001.



Thus, it is notable that protection of some sectors of the economy might be in the national interests of the country. Such protection might forestall the outward flow of resources, which has been accelerated by the ownership of privatised companies by foreign companies.<sup>160</sup> Policies designed to protect the national economy of a country are already being used by a vast majority of countries. For instance, the US government imposes a 170% tariff on sugar from other countries in order to protect its sugar industries.<sup>161</sup>

Whilst privatisation can enhance efficiency and profitability,<sup>162</sup> it is also possible for the process to impact negatively on private companies' liquidity, labour, and social stability. Indeed, in the absence of sufficient safeguards, it is not inconceivable that some imprudent directors might find their way to the boardrooms of privatised companies. To avoid such an eventuality the government needs to do more in terms of streamlining the privatisation process. This is because lack of transparency in the privatisation process increases political and social costs, as it makes the selection of buyers less efficient and contributes to loss of public confidence in the process. For privatisation to be successful, there is also a need to have in place a stable corporate governance structure for privatised firms. As SRI International notes:

"Policy reforms to ensure competitive markets in areas of pricing, trade, policy reform, flexible labour policies, and elimination of legal monopolies are all needed in order to maximise the efficiency gains from privatisation. Not all of these policies can be adjusted at once, nor should privatisation be delayed until all these problems are solved. Private enterprise development and policy reform should be built into the privatisation process in an interactive way.

---

<sup>160</sup> Foreign companies own most of the privatised companies because the locals have limited capital and skills. See Njenga, "How Anglo-Saxons Continue to Enslave Africans", *East African Standard*, 3 June, 2001.

<sup>161</sup> It imposes a 140% tariff on sugar from the European Union, 265% on Japanese sugar, 30% on Russian sugar, 80% on Indian sugar, 130% on South African sugar, 35% on Australian sugar, and 27.5 % on Brazilian sugar. See Keng'ore, op cit n 21.

<sup>162</sup> Kenya Airways became competitive and profitable after privatisation. See "KR to go Public, Government Says", *Daily Nation*, March 15, 2000.

Privatisation should be used as a catalyst for further reform in these areas."<sup>163</sup>

The Government prefers to divest its interests in parastatals by selling to strategic partners rather than offering of shares to the public. Although the Government could be adopting this strategy on the basis that the capital market in Kenya is not well developed, there is a possibility that it also seeks to exploit the process in order to engender political patronage.

## **6.5 Conclusions**

The poor performance of parastatals has had adverse effects on the economy of Kenya. Although the initial objective of having parastatals was to foster the development of the private sector and the provision of public services, the current state of parastatals' management, and the way that they are regulated, militate against the attainment of such objectives. In fact, as a result of their indebtedness to the government, parastatals have been a drain on, rather than a boon to, the economy.

It is clear that the regulatory framework in place is ineffective. Having been adopted at independence, the framework can hardly be effective in regulating today's business environment, which has become sophisticated due to technology and globalisation.

As such, failure on the part of the government to adopt workable solutions to resolve inefficiency can only make the crisis worse.

The overlapping regulations governing parastatals, coupled with the political appointment of directors, make it difficult to ensure that there is accountability in the sector, as directors' impartiality and integrity is often compromised.

Although it true to some extent to say that the poor performance of parastatals has been caused by their role in supplementing the private sector, poor remuneration, and the policies of international lending agencies, clearly a vast majority of parastatals experience liquidity problems, as a result of the presidential and

---

<sup>163</sup> SRI International and Mwaniki Associates, op cit n 2.

ministerial control of their operations. This results in the parastatals being run, not in the interests of the corporation, but for political interests. Thus, the corporation can be protected by empowering another independent body, such as Parliament, to vet the appointment of directors. Given that the arbitrary ministerial directions play a role in limiting parastatals' powers to pursue their objectives, requiring ministers to present in Parliament such directions can also reinforce accountability, as Parliament would demand accountability and require ministers to adopt corporate governance practices. Having such an arrangement in place would facilitate the appointment of qualified persons, and in turn, enhance the performance of the boards by raising the standards of care expected from directors.

Although privatisation of parastatals would give them autonomy, and in turn, increase efficiency by reducing political influence, there is a need to have in place effective regulations that would not only guide the privatisation process but also protect the privatised corporations from abuse. This is because the lack of effective regulation of directors that occurs in the private sector is not only mirrored in parastatals, but its detrimental effects are even more obvious.

## CHAPTER SEVEN

### 7.0 SELF-REGULATION OF DIRECTORS

#### 7.1 Introduction

As a result of the dependency of Kenya<sup>1</sup> on donor funding, the country has recently experienced increased pressure to reduce the need for Government intervention in the economy. The influence of donor agencies has particularly encouraged the country to reduce the need for regulation in the future by utilising private market forces. Organisations, such as the Commonwealth Association for Corporate Governance and the Commonwealth Secretariat, have encouraged African countries to adopt practices that would contribute to more effective self-regulation (Self-regulation arises when a group of individuals or institutions regulate their activities in their common interests without government encouragement or monitoring)<sup>2</sup> of corporations both before and after full privatisation.<sup>3</sup> Addressing the consultative forum for corporate governance in Nairobi, the Commonwealth Association for Corporate Governance representative said that:

“I suggest to you, here today, that the incentive to the corporation is to adopt internationally accepted standards of governance and business practice to promote its prosperity and to attract investment. While on the other hand, the incentive to the state is to strengthen the economy and discourage mismanagement through a credible regulatory and commercial framework as I have already said.”<sup>4</sup>

---

<sup>1</sup> The dependency has been so entrenched that the Attorney General of Kenya recently submitted draft graft laws for approval to the IMF before the Cabinet and Parliament saw them. See "Welcome to Kenya, IMF's Little Colony", *Daily Nation*, 20 May, 2001.

<sup>2</sup> See Baggot, "Regulatory Reform in Britain: The Changing Face of Self-Regulation", (1989) 67 *Public Administration* 435 at 438.

<sup>3</sup> Consultative Forum for Corporate Governance in Africa speech by the Commonwealth Association for Corporate Governance (CACG) Representative, on 30 October 2000 in Nairobi, Kenya. <[www.Thecorporatelibrary.com/countries/Kenya/Consultative\\_forum.htm](http://www.Thecorporatelibrary.com/countries/Kenya/Consultative_forum.htm)>

<sup>4</sup> Ibid.

Despite the pressure by the donor agencies, some Kenyan policy makers prefer a local set of policies to those imposed by the donor agencies. For instance, the Nairobi Stock Exchange Chairman in 2001 criticised the implementation of the International Accounting Standards (IAS) on the basis that they were only favourable towards foreign owned multinational banks, as Kenya's banks were constrained by the short term nature of Kenyan deposits. Another reason advanced against the IAS was that the Kenyan judicial system discourages the quick dispensation of commercial cases.<sup>5</sup> Similarly, the Kenyan Parliament recently disagreed with the wishes of the Treasury, the World Bank and the IMF<sup>6</sup> by passing a bill limiting the interest rates of banks.<sup>7</sup> The passage of this bill, coupled with the widespread public support and sentiments against the bankers association for a lack of sense of corporate citizenship, clearly indicated the mistrust of self-regulation by the industry.<sup>8</sup>

Self-regulation arises when an association of individuals or institutions delegates to prescribed individuals the supervision of their activities. On the other hand, governmental regulation involves supervision by civil servants working in a government ministry. As such, whilst self-regulatory codes bind members of organisations on the basis that they have agreed to be bound by them as part of the group, governmental regulations bind members of organisations because they have the force of law.<sup>9</sup>

---

<sup>5</sup> "Banker, NSE Chief Riled by IAS", *East African Standard*, 17 May, 2001.

<sup>6</sup> The IMF policies have been criticised by the United Nations Conference on Trade and Development (UNCTAD) for extending its surveillance to financial sector issues in borrower countries causing flawed diagnosis and undermining their sovereignty. UNCTAD links the East Asia economic crisis to donor agencies excessive conditionalities. To improve the global money market, UNCTAD advocates for balanced treatment of debtor and creditor nations regarding standards, codes, transparency and regulation; more symmetrical surveillance; more stable exchange rates; less intrusive conditionality and more democratised and participatory multilateral institutions and processes. See "Global Trends and Prospects and Financial Architecture", UNCTAD's Trade and Development Report 2001 in "UN wants Financial Markets Reformed", *Daily Nation*, 8 May, 2001.

<sup>7</sup> Commenting on the ineffectiveness of IMF's remedies, Professor Joseph Stiglitz, a senior fellow at the Brookings Institution and former World Bank's Chief Economist said, "IMF experts believe they are brighter, more educated and less politically motivated than the economists in the countries they visit. In fact, the economic leaders from those countries are pretty good in many cases brighter or better educated than the IMF staff, which frequently consists of third-rank students from first-rate universities... Trust me I have taught at Oxford University, MIT, Stanford University, Yale University and Princeton University, and the IMF almost never succeeded in recruiting any of my best students." See, *op cit* n 1.

<sup>8</sup> "Are Kenyans Demanding Back a Pound of Flesh?" *The East African*, 25 December, 2000.

<sup>9</sup> Codes are unofficial or self-regulated set of rules while regulations are official rules set by the state. See Kihumba, "Setting Governance Policies; Codes or Regulations?" A Panel Discussion Paper

In view of the complex nature of corporate governance issues, it is important to analyse the particular circumstances of the legal and regulatory system, business structure, cultural characteristics and heritage of Kenya before making suggestions for adopting a framework to address issues of corporate governance.<sup>10</sup> This chapter seeks to establish whether self-regulation by directors would be more effective than statutory control. In doing so, it will compare self-regulation with governmental regulation and assess the recommendations made by the donor agencies with a view to identifying the most suitable system for Kenya.

## 7.2 Background

In order to adopt a market-friendly regulatory framework, the country has made significant steps to establish a code<sup>11</sup> of practice for directors, as an incentive to honest and prudent behaviour. The Private Sector Corporate Governance Trust (PSCGT)<sup>12</sup> of Kenya has drafted principles and a sample code for corporate governance.<sup>13</sup> The code is based on the Commonwealth Association of Corporate Governance Guidelines. The guidelines have been designed with emerging and transitional economies in mind. However, they also accommodate some of the more advanced requirements of international investors and multilateral international agencies. The guidelines consist of fifteen principles of corporate governance targeted at boards of directors and corporations with a unitary board structure. The principles apply to boards of directors in public, private, family owned or state owned corporations. They are also applicable to executive and non-executive directors, Non Governmental Organisations (NGOs) and other such agencies.

---

Presented at the Global Conference on Corporate Governance on 10-11 July, 2000 in the Southern Connecticut State University New Haven, USA <  
<http://www.gcgf.org/library/speeches/Kihumba.doc>>

<sup>10</sup> Op cit n 3.

<sup>11</sup> A code is "a set of rules which are accepted as general principles, or a set of written rules which state how people in a particular organisation or country should behave. See Cambridge International Dictionary of English, (Cambridge University Press, 1995). The OECD defines codes as "commitments voluntarily made by companies, associations or other entities, which put forth standards and principles for the conduct of business activities in the market place. See OECD Working Party of the Trade Committee, Codes of Corporate Conduct; An Inventory, 1998, p 5.

<sup>12</sup> The Private Sector Initiative for Corporate Governance was in March 1999. Its mission is "to formulate and put in place principles and a code of best practice for corporate governance in Kenya and to develop a sustainable institutional framework for the implementation of those principles so as to enhance and improve national and regional capacity, capability and competitiveness for wealth production and creation through viable, efficient and profitable business enterprises." See <[www.corporategovernance.co.ke](http://www.corporategovernance.co.ke)>

Although the code drafted by PSCGT is not yet in force,<sup>14</sup> it is worth noting that Kenya has other codes of conduct regulating various professions.<sup>15</sup> Since other professional societies have utilised codes of conduct, it has been argued that the same approach should be adopted in the corporate realm.<sup>16</sup> The Code generally focuses on the protection of investors by, for instance, emphasising the need to have disclosure of financial information by directors, the appointment of audit committees, risk management and discouraging insider dealing.<sup>17</sup>

Sometimes, self-regulatory arrangements develop into fully-fledged self-regulatory organisations with internal statutory rules; dedicated financial resources; formal structures involving shareholders, managers, and employees; codes of conduct; and oversight procedures.<sup>18</sup> The responsibilities of a self-regulatory organisation usually involve the regulation of market participants, dispute resolution and enforcement actions and pre-commitment of resources. Self-regulatory authorities are strengthened when members pre-commit resources which are used when a member experiences insolvency problems. Due to pre-commitment each member is encouraged to keep a check on the other. In turn, this promotes enforcement of information disclosure rules.<sup>19</sup> By regulating market transactions, a regulatory authority ensures that transactions are dealt with by each member according to

---

<sup>13</sup> See [http://www.combinet.net/governance/FinalVer finlvndx.htm](http://www.combinet.net/governance/FinalVer%20finlvndx.htm)

<sup>14</sup> Kenya is not exceptional because even other countries formulated their codes of corporate governance in the 1990s. One of the first codes to be published was by a Committee on the Financial Aspects of Corporate Governance chaired by Sir Adrian Cadbury in Britain on 1 December, 1992. The Cadbury Committee was set up in 1991 by The Financial Reporting Council, The London Stock Exchange and the Accountancy profession to examine the financial aspects of corporate governance. Consequently, the Cadbury Report of the Committee on the Financial Aspects of Corporate Governance (London: Gee, 1992) was issued in 1992. It summarised the recommendations on directors as a 'Code of Best Practice'. See B Pettet, *Company Law* (Pearson Education Limited, 2001) p 209.

<sup>15</sup> Outside the professional organisations, such as the Law Society, the medical, and the accountancy professions, the government has also given power to Non-Governmental Organisations (NGOs) to regulate themselves. In doing so, the government sought to protect both the NGOs and the citizens from the unscrupulous NGOs. The government was prompted to do so by, first, the improvement of the relationship between itself and the NGOs. Second, the donor pressure from IMF and World Bank. See Yaansah, "An Experiment in NGO Self-Regulation in Kenya", in "Self Regulation Report-Kenya" (Washington DC; International Centre for Not-for Profit Law) p 1. <[www.icnl.org/journal/voliss/Kenyasr.html](http://www.icnl.org/journal/voliss/Kenyasr.html)>

<sup>16</sup> Kihumba, op cit n 9.

<sup>17</sup> Ibid.

<sup>18</sup> Bossone and Promisel, "The Role of Financial Self-Regulation in Developing Economies, (Washington DC, The WorldBank) p. 1 <[www.worldbank.org/finance/html/self-regulation-indeveloping.html](http://www.worldbank.org/finance/html/self-regulation-indeveloping.html)>

<sup>19</sup> Ibid.

agreed rules.<sup>20</sup> Rules on information disclosure and sharing help a self-regulatory authority to achieve its objectives, as there can be no incentives for honest behaviour if participants conceal information.

Since codes control the conduct of a small or restricted group of persons by offering guidance within the group, it can be argued that they enable groups to have integrity, viability and survival.<sup>21</sup> While the implementation of codes can hardly be successful at the corporate level without the full commitment of the board and encouragement at the national level,<sup>22</sup> the codes themselves need to be based on practical and real issues that local corporations consider important. As a result, local corporations must be involved in the formulation of codes.<sup>23</sup>

### **7.3 Regulation of Market Participants**

To ensure that market participants have an adequate level of reputation, a regulatory authority sets admission criteria requiring willing participants to meet minimum standards of capital creditworthiness and expertise. For instance, despite there being no self regulatory authority for directors in Kenya, the Private Sector Corporate Governance Trust (PSCGT), which was established in 1999 to promote good corporate governance in Kenya, has been running courses for directors with a view to enhancing their competence.<sup>24</sup>

A regulatory authority may also require new members to be introduced by existing ones, who act as guarantors of the candidate's reputation. A self-regulatory authority also sets the rules of conduct governing member relationships and their business activity. This may include rules of ethical behaviour, compliance with membership obligations, sound performance and maintenance of minimum levels of financial strength. The compliance requirement reduces costs between members.

---

<sup>20</sup> Ibid.

<sup>21</sup> Kihumba, op cit n 9.

<sup>22</sup> Organisations having genuine interests in corporate governance are also important in promoting the usefulness of the codes. For an organisation to achieve this objective, it is considered necessary for it to engage in training, research, collecting and collating information, recognising and making awards to organisations that maintain high standards of corporate governance. In addition, the organisation needs to be independent, objective, and professionally competent to undertake these tasks. See Kihumba, op cit n 9.

<sup>23</sup> Ibid.

<sup>24</sup> <[www.corporategovernance.co.ke](http://www.corporategovernance.co.ke)>. United Kingdom's Department of Trade and Industry has leaflets that are designed to promote awareness. See <<http://www.dti.gov.uk>>



Self-regulatory authorities also impose criteria for sanctions in the event of non-compliance. When members engage in serious misconduct, they risk suspension and exclusion from the organisation.

Although self-regulatory bodies are meant to have no links with the government, some of the self-regulatory authorities that supervise the affairs of companies, equity markets, and financial services, have some level of government involvement. In the UK, for instance, the Financial Services and Markets Act 2000 stipulates the requirements needed for a company's shares to be listed for trading on a stock exchange. It also governs the affairs of the firms carrying on investment business. The statute however confers most regulatory powers on the Treasury while the Financial Services Authority (FSA) has the responsibility for administering many aspects of the legislation.

The factors that have been associated with the need to formulate codes of corporate governance in the last decade have been identified as:

- Globalisation, which has been made possible by technology, trade liberalisation and a “freer” less controlled uni-polar world.
- Corporatisation and privatisation which has seen the world control of economic and social resources being directed less and less by the State and more and more by the private corporate sector.
- Democratisation which has meant the expansion of individual freedoms including the right to know how agents manage resources placed in their hands.
- Competition, which has been made possible by globalisation and liberalisation, has put into focus the need for high performance and enlightened leadership.

- High profile corporate abuse and failures (Maxwell, BCCI, Barings, etc) which has startled regulators, investors and society out of their slumber.
- Shareholder activism driven by increased democratisation, institutionalisation of investments.
- Stakeholder activism driven by environmentalists, trade unionists, consumer rights activists, enlightened and public responsive governments, enlightened capitalism etc.<sup>25</sup>

In their “Standards of Self-Regulation of the Securities Markets” the International Capital Markets Group (1992) identifies the following main benefits of self-regulation:

- "In self-regulation, it is possible to impose ethical standards, which go beyond those which can be imposed by statutory legislation.
- Self-regulators are directly accountable to their members. Self-regulatory systems have built-in motivation to regulate for effectiveness and least interference.
- Self-regulation operates in an environment where there is a willingness to accept regulations formulated from within for the common good of the group.
- Self-regulators, being “part” of the group understand the issues more intimately and are therefore more sensitive to the needs of the regulated and the whole group.
- The regulated have an opportunity to participate at all levels of the self-regulatory process thereby making it easier to appreciate and accept new regulations.

---

<sup>25</sup> Ibid, p 5.

- Self-regulation has a built in system of checks and balances in that the regulated see it as their duty to exposes non-compliance.<sup>26</sup>
- Self-regulators have the ability, being the players, to comprehend complex regulatory problems at an early stage and to develop corresponding solutions to these issues before they reach a stage where they can disrupt the group operations.
- Self-regulators have at their disposal a reservoir of resources, which are sometimes available at no cost and within easy reach.
- Self-regulation is more comprehensive yet much cheaper than official regulation to operate and implement.
- As a result of self-regulation, governmental resources including funds and personnel are freed to be used where they are most effective. This optimises use of scarce resources."<sup>27</sup>

In order to assess whether the advantages of self-regulation would apply to Kenya, it is important to discuss some in more details.

---

<sup>26</sup> In the UK, there is high level of compliance with the Code of Best Practice. A survey conducted by Pensions Investment Research consultants indicated that 93% of a sample of FTSE All Share Index companies have a board made up of one-third of non-executive directors. This complies with the Hampel Report , which recommended that non-executive directors should be more than one-third of the board, as they would not play an effective role if they were made up of less. The Hampel Report was published following the establishment of the Committee on Corporate Governance chaired by Sir Robert Hampel in 1995 (Hampel Final Report on Corporate Governance (Gee, London, 1998).

The Committee produced a document, which was a set of principles, and a code, which embraced Cadbury (Cadbury Report on the Financial Aspects of Corporate Governance (Gee, London, 1992), Greenbury (Sir Richard Greenbury, Directors' Remuneration: The Report of a Study Group ( Gee, London, 1995), and their own work. The London Stock Exchange published the document in March 1998 as the draft combined code. Although the Combined Code is not part of the rules, it is an appendix to FSA Listing Rules. See Hampel Report, para 3.14.

<sup>27</sup> Kihumba, op cit n 9, p 4.

## 7.4 Advantages and Disadvantages of Codes

### 7.4.1 *Dispute Resolution*

For a self-regulatory authority to be successful, there is a need for the adjudication process and dispute resolution to be efficient. An efficient adjudication process, for instance, offers advantages over the national courts in Kenya, as the judicial process is slow. Kenya is one of the Commonwealth countries with the highest number of pending court cases. Some court cases in Kenya take more than a decade to be finalised.<sup>28</sup> Commenting on the state of the judicial system in Kenya and the introduction of International Accounting Standards, the Daima Bank Managing Director, Sam Muumbi, argued against IAS on the basis that the Kenyan judicial system discourages quick dispensation of commercial cases. *He took the view that the slow judicial process would be inconsistent with the IAS spirit, whose financial disputes are settled within 90 days.*<sup>29</sup> Given that the Kenyan judicial process prejudices the smooth application of some measures, which require expedient settlement, there is little chance of self-regulation being effective, unless alternative dispute resolution procedures are adopted.

### 7.4.2 *Good Leadership Focus*

It can be argued that directors are offered motivation to achieve higher performance by codes that give them the goal<sup>30</sup> upon which they should focus. For instance, the Kenya Private Sector Initiative for Corporate Governance strategy paper states:

"Within the private sector, the corporation has been identified as the principal organ through which business is

---

<sup>28</sup> "Kenya Ranked High in Pending Cases List", *East African Standard* May 17, 2001.

<sup>29</sup> Op cit n 5.

<sup>30</sup> Principle A1 of the UK's combined code provides that "every listed company should be headed by an effective board which should lead and control the company." Code provisions A.1.1 to A.1.6 provide that the board should meet regularly; the board should have formal schedule of matters specifically reserved to it for decision; there should be a procedure agreed on by the board for directors in the furtherance of their duties to take independent professional advice if necessary, at the company's expense; all directors should have access to the advice and services of a company secretary; all directors should bring an independent judgement to bear on issues of strategy, performance, resources, including key appointments and standards of conduct; every director should receive appropriate training on the first occasion that he or she is appointed to the board of a listed company. Pettet B, op cit n 14, p 209.

transacted. It is not surprising therefore that attention should now focus on the leadership role in corporations."<sup>31</sup>

Such a focus serves as a constant reminder to directors and, in turn, promotes good corporate governance by laying emphasis on the need for ethics, integrity and probity in the conduct of business.<sup>32</sup>

#### **7.4.3 Re-awakening of Shareholders**

Although shareholders are the owners of business enterprises, they have had in the past a dormant role in the governance of companies. As illustrated in Chapter Five, whilst it is the shareholders who have the responsibility of appointing and removing directors, it is not always possible for them to do so especially when they constitute the minority. This is because they cannot litigate in the name of the company, as the company is the only body that is entitled to sue a *miscreant director*.<sup>33</sup> Despite this enforcement restriction, there has been an increase in shareholder activism in the recent past. Illustrative of this is a recent uncommon demand by a Kenya Commercial Bank shareholder for an extraordinary meeting to discuss the operations of the bank. In addition to rejecting the re-election bid of three directors who were retiring by rotation, the shareholder contended that shareholders had lost faith in directors over the heavy losses incurred by the bank.<sup>34</sup> Since the existing regulations for directors are bulky and difficult to understand, there is no doubt that the activism of shareholders can be enhanced by a clear stipulation of the role of shareholders in corporate governance. The Private Sector Corporate Governance Trust's (PSCGT) first principle of corporate governance in Kenya obliges shareholders to:

“Jointly and severally protect, preserve and actively exercise the supreme authority of the corporation in general meetings. They have a duty, jointly and severally, to exercise that supreme authority of the corporation to ensure that only competent and reliable persons, who can add value, are

---

<sup>31</sup> Kihumba, op cit n 9.

<sup>32</sup> Ibid.

<sup>33</sup> *Musa Misango v Eria Musigire & Others* [1966] EA 390. The rule in *Foss v Harbottle* (1843) 2 Hare 461 was applied in this case.

<sup>34</sup> Kihumba, op cit n 9.

elected or appointed to the board of directors, ensure that the board is consistently held responsible and accountable for the efficient and effective governance of the corporation so as to achieve corporate objectives, prosperity and sustainability, change the composition of the board that does not perform to expectation or in accordance with the mandate of the corporation.”<sup>35</sup>

#### ***7.4.4 Interface with Regulations***

Since the individuals who make and implement regulations may not be properly in touch with the impact their decisions have, regulation from outside can yield enforcement problems in the regulated market. As a result, self-regulation can be a good alternative in certain circumstances.

Although self-regulatory codes are thought to be effective in achieving the intended results, regulations may sometimes be more effective as they tend to be stricter. For regulations to be effective, Kihumba argues that they must be guided by the following principles:

"Regulating when it is absolutely necessary to regulate; regulations must be simple and clear as complex regulations are expensive to apply and difficult to be complied with; regulations must be specific and targeted as it is important to understand the nature and complexity of the problem to be controlled; regulations must be flexible enough to accommodate future changes to the problem or matter under regulation; regulations should not be made to punish non-compliance, but rather to assist compliance as sanctions should be tools of correction and not punishment; regulations should integrate with existing rule systems."<sup>36</sup>

---

<sup>35</sup> Ibid.

<sup>36</sup> Ibid.

Given that self-regulation authorities need autonomy to a large extent in order to be effective, the limited leadership role of the government may lead to incoherent policies and regulations being implemented by self-regulatory authorities.<sup>37</sup>

#### **7.4.5 Flexibility**

Changing circumstances in the market tend to militate against regulation because the public officials who administer the regulatory scheme do not act promptly. Given that the process of changing the law through Parliament is slow, self-regulatory authorities are considered more appropriate to effect such changes as they do not have the "same onus as public bodies to give public notice, consult interest groups, or take analogous procedural steps before making rule changes."<sup>38</sup>

Another problem associated with public bodies is their tendency towards rigidity and

bureaucracy. Since bureaucrats are seen to be too preoccupied with past practices and technical details, they are hardly likely to be flexible. As Cheffins observes, the regulated community is most likely to be uncomfortable because they "will feel that they are having to deal with pointless, time-consuming procedures administered by individuals suffering from an obsession with format."<sup>39</sup>

A self-regulatory regime, on the other hand, can regulate in a manner that ensures that there is no obsession with format, and the relationship between interested parties is not confrontational as the regulatory authority has the same attitude as the regulatory community. Illustrative of the smooth operation of a self-regulatory authority is the UK's Take-overs Panel whose rule making and administrative tasks are flexible and expedient.<sup>40</sup>

It is worth noting, however, that self-regulatory bodies can sometimes be as rigid as public regulatory bodies. For instance, the Securities and Investment Board (SIB)

---

<sup>37</sup> In the UK, for instance, self-regulation has led to fragmentation of regulatory responsibility, which can lead to overlap of jurisdiction. Several regulatory authorities exist. These include: the Take-over Panel, Accounting Standards Board, Financial Services Authority, and SRO. Similarly, while the Bank of England, the DTI and the Treasury supervise company affairs, none of these acts as a leader.

<sup>38</sup> BR Cheffins, *op cit* n 36, p 379.

<sup>39</sup> *Ibid*, p 379.

<sup>40</sup> Calcutt, "Company Law Lecture - the Work of the Take-over Panel" (1990) 11 Co Law 203 at 206.

produced bulky rulebooks in 1980 to be implemented by regulators. This led to complaints by financial institutions and subsequently culminated in the provision of a more flexible approach to rule-making by the government and the SIB.<sup>41</sup>

Another factor that might contribute to lack of flexibility on the part of self-regulatory authorities is the composition of the staff. Where the regulatory authorities are staffed with civil servants, they are more likely to perform in a manner similar to that expected from government agencies.<sup>42</sup>

The flexibility of regulatory authorities may also be affected by excessive regulatory backing. Since self-regulatory authorities sometimes rely on Parliament to provide statutory backing to their policies, there is usually a danger of eroding their flexibility.<sup>43</sup>

Another factor that casts doubts on the desirability of flexibility is that flexibility can have negative effects. Although flexibility allows the regulatory authorities to amend rules in light of the changing circumstances, arbitrary and quick amendments might prejudice a part of the regulated community in that there may be little or no chance to submit views on changes.

Also, flexibility might adversely affect fair adjudication. For instance, a regulatory authority wishing to adjudicate expeditiously on matters might opt to exclude vital evidence or witnesses.<sup>44</sup> However, such problems posed by lack of flexibility can be resolved by imposing procedural requirements.<sup>45</sup> Also, to make the rule making of regulatory authorities fair by ensuring all interested parties are consulted, Parliament

---

<sup>41</sup> Companies Act 1989 Ss. 192, 194, and 195.

<sup>42</sup> In the UK, former civil servants have continued to fill key posts in SIB. See BR Cheffins, *op cit* n 36, p 382.

<sup>43</sup> Senior SIB officers in the UK have voiced concern over this. See BR Cheffins, *op cit* n 36, p 382.

<sup>44</sup> The UK's Take-over Panel has been criticised for failing to permit lawyers to present cases and for failing to allow parties to cross-examine each other's evidence directly. See Jowel, "The Take-over Panel: Autonomy, Flexibility and Legality", [1991] *Public Law* 149 at 156-157. Illustrative of the failure of the regulatory authorities is the case of *R v Panel on Take-overs and Mergers ex parte Guinness Plc* [1989] 1 All ER 509 where the court criticised the panel for declining to grant Guinness, the take-over bidder, adjournments to prepare its case more thoroughly and for failing to allow the various witnesses requested by Guinness.

<sup>45</sup> In the UK, Parliament has set down guidelines requiring regulators acting within the mandate of the Financial Services Act 1986 to have reasonable and fair procedural rules to deal with the



may compel authorities to take into consideration all the relevant submissions from interested parties before making amendments.<sup>46</sup>

As the foregoing analysis shows, flexibility is not always a positive attribute.

#### 7.4.6 *Expertise*

Self-regulatory authorities are also preferred on the basis that their officials are usually in a better position to understand the conduct with which they deal.<sup>47</sup> In view of the technical nature of the duties of directors, it has been considered necessary to have self-regulation, rather than governmental regulation, as civil servants are considered to be less likely to be as knowledgeable as their counterparts in the private sector as far as technical issues surrounding regulation of directors go. Moreover, authorities are better placed to formulate rules and practices which are pertinent to the industry because they can more effectively enforce disclosure rules by peer monitoring.<sup>48</sup> As a result, the authorities have an incentive to keep up with institutional and organisational development in other countries.<sup>49</sup> As Cheffins notes:

“The proximity which a self-regulatory body has to the market place should leave it well positioned to contact and recruit industry members to volunteer some time or to work on the staff on an ongoing basis. If people with practical experience take on a key role, a self-regulatory authority should be in close touch with what is going on. This is important because, as the chairman of the stock exchange said in 1992, practitioners tend to have the keenest noses which is something that cannot be matched by people of limited experience, however intelligent and well qualified.”<sup>50</sup>

---

disciplinary matters and membership. The guidelines stipulate that authorities must have appeal mechanisms.

<sup>46</sup> In the US, the Administrative Procedure Act requires the SEC, together with all other federal agencies, to publish proposed regulations and seek written comments of interested parties. Also, the UK's Financial Services Act 1986 in Ch V, Schedule 2 and 4 identifies certain matters which regulatory authorities have to deal with. See BR Cheffins, *op cit* n 36, p 385.

<sup>47</sup> R Baldwin et al, *Regulation and Public Law* (London; Weidenfeld and Nicolson, 1987) at 45-6.

<sup>48</sup> Bossone and Promisel, *op cit* n 18, p 9.

<sup>49</sup> *Ibid*, p 3.

Although self-regulatory bodies offer the expertise advantage, they might be as inefficient as government agencies when they retain permanent staff who subsequently lose touch with the practices of the day. Moreover, Kenya might suffer from lack of institutional and human resources, which might constrain the effectiveness of an authority. Again, given that there is limited competition in the security markets of Kenya, self-regulation may not be sufficient to ensure safe markets.

#### **7.4.7 Cost**

Pitted against statutory regulations, self-regulatory codes are usually preferred because the regulated community is considered less likely to comply with statutory regulations, as they are imposed on players by the regulators. Besides, they are considered to be more expensive to administer than self-regulatory codes.

It is true to observe that government regulation generates some costs, as the officials administering the law have to be paid. On a similar note, a self-regulatory authority also incurs costs of maintenance. Since experts are able to handle complaints expeditiously, self-regulatory authorities are able to operate in more cost-effective ways than the government.<sup>51</sup> The same point can be made in relation to flexibility. Since a self-regulatory authority is able to amend its regulations easily, it can do so and as a result save more costs than a governmental agency. When the government does not control a self-regulatory authority, it saves the costs that would otherwise be paid to civil servants by the government.<sup>52</sup>

It is notable that the cost of running a regulatory authority is borne by the industry in question, which in turn passes the costs on to its investors and customers. So, the burden is passed on to the private sector, which in turn operates as a tax on the market participants. Although this might appear not to have distinct cost advantages, requiring practitioners to pay the costs of regulation appears to be in order because the misdeeds arising from an unregulated professional environment

---

<sup>50</sup> BR Cheffins, *op cit* n 36, p 387.

<sup>51</sup> *Ibid*, p 391.

<sup>52</sup> Longstreth, "The SEC After Fifty Years: An Assessment of its Past and Future, (1993) 83 Colum L Rev 1593 at 1598.

would affect the practitioners and affect their standing in the community.<sup>53</sup> Although the costs are subsequently borne by the customers, this can be justified on the basis that it benefits the country as a whole to have a properly regulated market.

In view of the existence of parastatals in Kenya, self-regulation might offer more effective cost controls than the present government control, which does not have effective measures of detecting when directors are not performing their duties well.

Despite the advantages of self-regulation, it is worth noting that self-regulation authorities do not always offer cost advantages especially where authorities are established pursuant to a statute. In such circumstances, they are usually required to meet certain criteria for them to be recognised.<sup>54</sup>

#### **7.4.8 Bias**

Self-regulation suffers from a distinct disadvantage for being susceptible to favouring, or appearing to favour, the interests of the members at the expense of other interests.<sup>55</sup> However, the media and public attention can sometimes reduce the risks of bias in a self-regulatory authority.<sup>56</sup>

Government supervision is also capable of being biased towards some members. For instance, the regulation of parastatals in Kenya by the Treasury and the Ministers has not been efficient because the government protects the interests of directors rather than those of the public. Illustrative of such bias is the appointment of a former chief executive of the Nyayo Tea Zone Development Corporation, Mr Isaiah Cheluget, as a commissioner with the Electoral Commission of Kenya, despite the failure on his part to pay money owed to the corporation and the numerous attempts made by Parliament to recover the money from him.<sup>57</sup> A regulatory authority may also become dependent on the regulated community where

---

<sup>53</sup> I Ayres and J Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (Oxford: Oxford University Press, 1992) p 114.

<sup>54</sup> For the UK's stock exchange to retain its status, it must provide adequate monitoring and enforcement mechanisms and must ensure that business is conducted in an orderly manner so as to protect investors. See Financial Services Act 1986, Sch 4, 5.2.

<sup>55</sup> *Financial Services in the United Kingdom*, CND 9453, (London: HMSO), 1985 at 15. For more on the lack of autonomy in self-regulating authorities see BR Cheffins, op cit n 36, p 398.

<sup>56</sup> Baggot, op cit n 2, at 445.

<sup>57</sup> "Probe M'Mukindia, Kiplagat-PIC", *East African Standard*, 29 July, 2000.

the existence of the authority is dependent on the continued existence of the industry in question. In such a situation, the regulations are not likely to be strict on the industry lest they affect their future interests.<sup>58</sup> As a result, the possibility of bias in self-regulatory authorities does not provide conclusive evidence as to why they should not be adopted.<sup>59</sup>

Also, self-regulatory authorities come with the risks of them being turned into cartels, which discourage competition. Moreover, the tensions between the managers and the authorities responsible for such authorities might discourage participation, hence diminishing long-term confidence in the market.

#### ***7.4.9 Enforcement Problems***

A regulatory authority operating without direct statutory backing bears the risk of not being effective as it would not have legislative authority to investigate, prosecute, or punish misconduct.<sup>60</sup> However, giving self-regulatory authorities enforcement powers is not without difficulties. Where an authority has adjudicatory responsibilities, the enforcement objective of the authority might demoralise investigating officers when complaints are struck out. Besides, an adjudicator who has previously worked as an investigator with the same authority is likely to be partial when deciding a matter.<sup>61</sup>

However, given the scarce resources of the government to enforce rules, self-regulation by the private sector can be favourable as it can raise resources, which would be used effectively to promote adjudication expediency.

---

<sup>58</sup> BR Cheffins, *op cit* n 36, p 403.

<sup>59</sup> For a detailed analysis of bias see BR Cheffins, *op cit* n 36, p 397-405.

<sup>60</sup> In the mid-1980s, such criticism was levelled against the Take-over Panel, The State Exchange, and The Accounting Standards Council for operating without direct statutory backing. This has since changed and some, such as The Financial Services Act 1986, provide enforcement powers to the self-regulatory authorities. See BR Cheffins, *op cit* n 36, p 412; Boyds "Ethics and Corporate Governance: The Issues Raised by the Cadbury Report in the United Kingdom", (1996) 15 J of Bus Ethics 167 at 172.

<sup>61</sup> In the UK, the Financial Services Act 1986 authorises the Financial Services Tribunal to hear appeals from investment firms, which the SIB has declined to authorise, or has disciplined.

## 7.5 The Way Forward

To promote greater business contribution to environmental and social progress, the International Chamber of Commerce favours business principles rather than codes and regulations. The principles are favoured as they:

“Play an important role in bridging cultural diversity within companies and in enhancing awareness of societal values and concerns. This is primarily a matter of persuasion and peer pressure rather than prescription. Business considers that demands by potentially unaccountable external groups seeking to impose codes and assert the right to independently audit companies’ compliance are counterproductive. The diversity of voluntary business initiatives and principles is both a resource and a source of innovation for addressing societal challenges. Their voluntary nature enables companies to find solutions and make improvements that regulations and command and control approaches could not have set in motion.”<sup>62</sup>

Although codes of corporate governance are sometimes preferred to government regulations because they are said to protect and promote the interests of stakeholders, good corporate citizenship, corporate social responsibility and corporate philanthropy,<sup>63</sup> that proposition can be refuted on the basis that companies can refuse to adopt codes of conduct, which would ultimately defeat their purpose.<sup>64</sup> Besides, even when they are adopted, they can still be narrow in scope. A survey by OECD in 1998 revealed that commitments to engage in corrupt practices, restrictive business practices or safeguarding property are less widespread in the industry. After

---

<sup>62</sup> “Responsible Business Conduct: An ICC Approach,” Policy Statement, *International Chamber of Commerce*, 6 May 2000. Article 7 of the International Chamber of Commerce Rules of Conduct to combat Extortion and Bribery obliges enterprises to draw up their own codes consistent with the ICC Rules and to apply them to the particular circumstances in which their business is carried out.

<sup>63</sup> Kihumba, op cit n 9.

<sup>64</sup> A survey by a private consulting agency, the Control Risks Group, has shown that multinationals in most instances either adopt corrupt practices or withdraw their investments from a corrupt country. See “Fighting Corruption in Developing Countries and Emerging Economies: The Role of the Private Sector”, Summary of OECD Development Centre Conference; Washington DC, 22-23, February 1999, p 2.

examining 233 codes it was noted that 85 of them dealt with only one aspect of conduct among five possible aspects, namely fair business practices, observance of rule of law, fair employment and labour rights, environmental stewardship, and corporate citizenship. Codes for companies operating in light industry covered labour issues more than others. On the other hand, companies operating in heavy industries were noted to include environmental issues more than those in other sectors.<sup>65</sup> Therefore, some corporations will only respond to stronger regulation and close monitoring by NGOs, trade unions, and consumer groups.

In light of the growing power<sup>66</sup> of multinational corporations and the subsequent imbalance of the power of the government, it is easy for multinational corporations to escape liability in a country with a weak regulatory regime.<sup>67</sup> The power wielded by multinational corporations enable them to out-negotiate the governments of poorer countries while making investment decisions. Since a country like Kenya is in need of foreign capital, it can hardly refuse concessions that are demanded. Although some of the companies succumb to pressure to adopt sound practices, the destruction of the environment, disregard of regulations, racism, and other vices are common occurrences.<sup>68</sup> Commenting on the ineffectiveness of self-regulation, a research co-ordinator at UN Research Institute for Social Development (UNRISD), Peter Utting, observed:

“While multinational corporations would prefer to comply through voluntary initiatives, the public interest can only be fully served through stronger regulation and monitoring.”<sup>69</sup>

---

<sup>65</sup> See OECD Working Party of the Trade Committee, Codes of Corporate Conduct; An Inventory, 1998, p 12.

<sup>66</sup> According to a report, Visible Hand, by the UN Research Institute for Social Development (UNRISD), some 60,000 corporations account for more than one-third of world exports. In 1998, the annual revenues of the top five corporations were more than double the total GDP of the 100 poorest countries. See “Corporate Responsibility Not Just About Standard Setting”, *Inter Press Service News Agency*, Fifth Issue, 30 June 2000. <[www.ips.org/geneva/3006/page1danielle.htm](http://www.ips.org/geneva/3006/page1danielle.htm)>

<sup>67</sup> In India, the Union Carbide’s gas leak in Bhopal killed about 15,000 people while Shell Company has continued to abuse human rights and pollute the environment in Nigeria. See, Ibid.

<sup>68</sup> Despite the failure to put in place enough environmental safeguards, the Kenyan Government has continued to back a Canadian company, Tiomin Ltd, in its bid to mine Titanium. Similarly, in the 1990s, Shell was criticised for gratuitous destruction of environment in Nigeria. Also, the Cameroon government continues to defend French firms that are destroying virgin forests through illegal logging. See “The Downside of the Much Hyped Globalisation”, *Daily Nation*, 20 May, 2001.

In the absence of internationally binding rules for corporations, national legislative measures will not effectively regulate directors of multinational corporations.<sup>70</sup>

According to a survey conducted in 2001 in Nairobi,<sup>71</sup> 69 percent of the respondents, who were all professionals, were against self-regulatory codes.<sup>72</sup> The disadvantages of having a self-regulatory scheme prompted the majority to feel that a self-regulatory code would not be successful, unless underlying problems, such as corruption, are solved.

The 1999 Human Development Report also called for a multilateral code of conduct because it considered multinational corporations to be too important for self-regulation. This initiative was, however, denounced by the UN Secretary General when he dismissed the recommendations as unnecessary and instead promoted a “Global Compact” which was aimed at *challenging business leaders to enact nine* voluntary principles derived from UN agreements on labour standards, human rights, and environmental protection.<sup>73</sup> Although many business associations, such as the International Chamber of Commerce, have endorsed the “Global Compact” there is no doubt that “the compact risks weakening the role of national governments, trade unions and stronger forms of civil society activism.”<sup>74</sup>

The report noted that corporate social responsibility should not concern itself with standard setting and compliance but “should also be about companies paying rather than avoiding taxes to welfare minded states.”<sup>75</sup>

---

<sup>69</sup> Op cit n 66.

<sup>70</sup> A survey conducted by the Trade Directorate of the OECD on 233 codes of conduct submitted by OECD member governments and non-governmental sources revealed that only 18% of the codes explicitly cite international standards set by the ILO Conventions, UN Declarations, and other international instruments. See OECD Working Party of the Trade Committee, *Codes of Corporate Conduct; An Inventory*, 1998. Commenting on the need to have international regulations, the President of Dutch Progression Foundation, Marcello Palazzi, observed that: “if we have transatlantic mergers, we need to have global competition and anti-trust legislation.” See, op cit n 66.

<sup>71</sup> The survey is considered in detail in Chapter Nine.

<sup>72</sup> The Kenyan Parliament recently disagreed with the wishes of the Treasury, the World Bank and the IMF by passing a bill limiting the interest rates of banks. See, op cit n 1.

<sup>73</sup> Ibid.

<sup>74</sup> Ibid.

<sup>75</sup> Along the Mexican and USA border, where companies have established factories in tax free zones, many municipalities lack adequate funds for proper infrastructure and schools. See, Ibid.

## 7.6 Conclusions

Although self-regulation has some distinct advantages over statutory regulation and may well be effective in some countries, it is also evident that self-regulation does not always offer clear-cut advantages. Thus, adoption of self-regulation in Kenya will not necessarily guarantee an effective regulatory framework for directors. Whilst self-regulation might reduce interference by the government in the market and the reluctance to punish miscreant directors, it will not be effective where self-regulatory authorities will need to resort to the judiciary for enforcement. However, although self-regulation might be effective if alternative dispute resolution procedures are adopted to resolve disputes, its effectiveness may well be affected by the various conditions which militate against self-regulation in Kenya. Such conditions may include poor organisation of the private sector, corruption, and the lack of international obligations. With the widespread corruption in Kenya, some directors and regulators might have difficulty avoiding participating in corruption when their competitors continue to engage in it. Since it is easier for the private sector to operate under a democratic system with an effective legal system and where the government is committed to fighting corruption, there is a need for the country to initiate changes in the current political and economic order so as to enable self-regulation of directors to be effective in the future.



## CHAPTER EIGHT

### 8.0 DISQUALIFICATION OF COMPANY DIRECTORS

#### 8.1 Introduction

Disqualification of directors protects the public by placing a prohibition on a miscreant director being involved, for a specific period, in the management of companies.<sup>1</sup> As well as preventing people without the necessary qualifications from managing companies, disqualification orders serve as a deterrent to those who might be tempted to engage in fraudulent activities.<sup>2</sup> Therefore, where a director breaches his obligations and, as a result, occasions loss to creditors, the public interest requires that the misconduct be punished by disqualification.<sup>3</sup>

Given that the State has the responsibility of providing an unbiased commercial environment, which ensures that the production of companies takes place smoothly and that the public is protected from miscreant directors, there is a need to balance these conflicting interests for the sake of a healthy economy. Although strict regulations in relation to the disqualification of directors may ensure that unfit directors do not serve on boards, it is undoubtedly the case that over-regulation or stringent disqualification proceedings may result in fewer people being interested in serving as directors. This would in turn adversely affect the economy, as few companies would be able to attract appropriate and competent directors.

Although shareholders generally decide who sits on a board of a company, some exceptions regarding the people they can choose are imposed by Parliament. The Companies Act<sup>4</sup> (the “Act”) contains some provisions that prescribe those who are able to act as directors.<sup>5</sup> As shareholders are not always able to prosecute errant

---

<sup>1</sup> S Griffin, *Personal Liability and Disqualification of Company Directors*, (Hart, 1999) p 131.

<sup>2</sup> *R v Kazmi* (1984) 7 Cr App Rep 115 at 116.

<sup>3</sup> Per Vinelott J in *Re Stanford Services* [1987] BCLC 607 at 620.

<sup>4</sup> Cap 486, Laws of Kenya.

<sup>5</sup> The Act makes provisions for share qualifications of directors (s 183), minimum age of appointment which is twenty-one years (s 186), disqualification of undischarged bankrupts (s 188), restraint on fraudulent persons from managing companies (s 189), and disqualification of persons of unsound mind and absence from meeting of directors for six months (Table A, Article 88).

directors, disqualification provisions supplement other provisions that seek to protect creditors and other stakeholders.<sup>6</sup>

Despite the existing requirements for the appointment of directors<sup>7</sup> and the disqualification provisions, companies continue to be run by incompetent, negligent, and fraudulent directors who have contributed to the insolvency of other companies.<sup>8</sup> Some 45 parastatals and other companies in which the Government has shares have been placed in receivership since 1980. Some of the directors who are responsible for the collapse of such companies have not only been appointed to other directorships, they have also been appointed to the Cabinet.<sup>9</sup>

For instance, despite the public outcry and prosecution<sup>10</sup> that followed the investigation of the former managing director of Kenya Posts and Telecommunications (KPTC), Mr Kipng'eno Arap Ng'eny, for masterminding the loss incurred by the corporation, he was retired in 1993 and appointed to head the Kerio Valley Development Authority.<sup>11</sup> According to the 1990/91 Auditor General's Report on the Kenya Posts and Telecommunication, the managing director was responsible for a number of fraudulent dealings. First, in 1985, the corporation lost 9 million Kenyan Shillings (£90, 000) after making payments to a firm of advocates to wind up the former Kenya External Telecommunications Corporations (KETC). The payment was made despite the fact that KETC was in the process of being merged with KPTC.<sup>12</sup> The winding-up process was rendered a sham when the two companies merged. Secondly, by 30<sup>th</sup> June 1990, the corporation had failed to remit

---

<sup>6</sup> In view of the difficulties encountered by minority shareholders in pursuit of errant directors, directors are unlikely to be accountable for their defaults unless the board changes hands or the company goes into liquidation. See Hicks, "Disqualification of Directors-Forty Years On" [1988] JBL 27 at 28.

<sup>7</sup> According to sections 183 (1) and 186 of the Act, directors must be natural persons, they must have share qualifications, and minors may not be appointed as directors.

<sup>8</sup> "45 parastatals, Govt firms in receivership" *East African Standard*, 12 July, 2001.

<sup>9</sup> Ibid.

<sup>10</sup> He was charged with fraud on July 17, 2000. See "Drama as Ng'eny is Finally Charged" *East African Standard*, 18 July, 2000.

<sup>11</sup> His prosecution followed the recommendations made by the Parliamentary Public Investments Committee. See "Minister Quizzed on Sh 250 Million" *Daily Nation*, June 1, 2000.

<sup>12</sup> K Kibwana, et al, *The Anatomy of Corruption in Kenya: Legal, Political and Social-Economic Perspectives*, (Nairobi: Claripress, 1996) p 73.

to various public authorities statutory deductions from staff salaries amounting to 176.5 million Kenyan Shillings (£1, 765,000).<sup>13</sup>

Despite several recommendations made by the Parliamentary Public Investment Committee that the people it adversely named should be charged in court and barred from holding public offices, such individuals continue to serve in high positions both in the government and the private sector.<sup>14</sup> As a result of such irregularity, the Public Investment Committee has proposed that legislation should be enacted to enable Parliament to vet all nominees for the leadership of parastatals.<sup>15</sup> The Committee in its Ninth Report highlighted the weaknesses of the present regulatory framework by citing the example of the former chief executive of the Nyayo Tea Zone Development Corporation, Mr Isaiah Cheluget, who had failed to pay money owed to the corporation despite numerous attempts to recover the money from him by Parliament. Despite this default he was subsequently appointed a commissioner with the Electoral Commission of Kenya.<sup>16</sup> As the Daily Nation notes:

“The tragedy in Kenya is that those who have mismanaged the Government, the Development Finance Institutions, and even multinational corporations are those who continue to circulate in and out of Government as ministers, assistant ministers, advisers and so on.”<sup>17</sup>

Such cases have done much to reduce the confidence of investors. In fact, the survey conducted in 2001 in Nairobi established that disqualification orders in Kenya are extremely rare. Ninety-two percent of the respondents agreed with this statement.<sup>18</sup> It is against this backdrop that this chapter examines whether the disqualification restrictions provided for by the Act are adequate to protect the interests of the corporate entity, creditors, and other stakeholders.

---

<sup>13</sup> Ibid.

<sup>14</sup> “Leakey, Wako Grilled by PIC”, *East African Standard*, 9 March, 2000.

<sup>15</sup> “New ‘List of Shame’ Tabled in Parliament”, *East African Standard*, 28 July, 2000.

<sup>16</sup> “Probe M’Mukindia, Kiplagat-PIC”, *East African Standard*, 29 July, 2000.

<sup>17</sup> Nyong’o, “How Bad Governance Strangles Business”, *Daily Nation*, 10 June, 2001.

<sup>18</sup> The results of the survey are discussed in detail in Chapter Nine.

## 8.2 Grounds for Disqualification

In Kenya, a director must cease to be a director if he fails to take up any prescribed shares within two months of his appointment.<sup>19</sup> A director is automatically disqualified if he becomes an undischarged bankrupt or if he makes any arrangement or composition with his creditors generally.<sup>20</sup> Other grounds, which necessitate disqualification of directors, include whether he is prohibited from being a director by reason of any order made under section 189. The section restrains fraudulent persons from managing companies. Further grounds for disqualification contained in the Act include: where a director is of unsound mind;<sup>21</sup> where he resigns his office by notice in writing to the company;<sup>22</sup> or he is absent without permission for more than six months from meetings of the directors held during that period.<sup>23</sup>

### 8.2.1 *Bankrupts*

Persons who are undischarged bankrupts are barred from acting as directors under the Act. The Act provides:

“If any person who has been declared bankrupt or insolvent by a competent court in Kenya or elsewhere and has not received his discharge acts as a director of, or directly or indirectly takes part in or is concerned in the management of, any company except with the leave of the court, he shall be liable to imprisonment for a term not exceeding two years or to a fine not exceeding ten thousand shillings or both.”<sup>24</sup>

As people who have failed to manage their finances, bankrupts are automatically disqualified from taking part in the management of companies. As such, their disqualification is not dependent upon wrongdoing, negligence, or the making of a disqualification order by the court. However, a bankrupt may apply to court for

---

<sup>19</sup> The Act, section 183.

<sup>20</sup> Ibid, section 188.

<sup>21</sup> Article 88 (d), Table A.

<sup>22</sup> Ibid, Article 88 (e).

<sup>23</sup> Ibid, Article 88 (f).

<sup>24</sup> The Act, section 188 (1).

leave to act as a director.<sup>25</sup> For leave to be granted, the bankrupt must show that he or she may be safely involved in the management of companies.<sup>26</sup>

Acting as a director while disqualified results in criminal penalties and personal liability<sup>27</sup> for the debts and other liabilities of any company in whose management a disqualified person was involved.<sup>28</sup> The personal liability extends to any person involved in the management of the company who knowingly acts on the instructions of a disqualified person.<sup>29</sup>

In the UK, the Company Directors Disqualification Act 1986<sup>30</sup> (hereinafter referred to as "CDDA") prohibits individuals who are undischarged bankrupts *from acting as* directors.<sup>31</sup> A director can also be disqualified on grounds of unfitness for entrusting the management of a company to someone known to be bankrupt or disqualified.<sup>32</sup> Apart from the automatic disqualification of *undischarged bankrupts*, *all other* grounds for disqualification require a court order specifying the duration of disqualification.<sup>33</sup>

Disqualifying bankrupts from managing companies is helpful as it prevents them from starting a business and raising credit using a limited liability company.<sup>34</sup>

### 8.2.2 Management of the Company

The Act requires the court, in its discretion,<sup>35</sup> to disqualify a person who is guilty of an offence as a director or promoter of a company, or in any way, whether directly

---

<sup>25</sup> The Act, section 188 (1).

<sup>26</sup> Section 188 (2).

<sup>27</sup> Section 188 (1).

<sup>28</sup> Section 323 (1).

<sup>29</sup> The Act states "any persons who were knowingly parties to the carrying on of the business in the manner aforesaid shall be personally liable." See Ibid section 323 (1) (a).

<sup>30</sup> The UK government introduced the Act to curb abusive practices as it was adopting a free market philosophy. The new laws were meant to punish miscreant directors and thereby deter misconduct. They were also aimed at facilitating screening so as to make it difficult for unsuitable individuals to run companies and in turn protect the public. Between 1998 and 1999, 1,284 disqualification orders were made under section 6, 20 under section 8, and 178 under the other provisions. See BR Cheffins, *Company Law, Theory, Structure, and Operation* (Clarendon Press, 1997) p 551; See S Mayson et al, *Company Law*, 17<sup>th</sup> Edition (Blackstone, 2000) p 720.

<sup>31</sup> Section 2, 11.

<sup>32</sup> *Re Moorgate Metals Ltd* [1995] 1 BCLC 503.

<sup>33</sup> The Insolvency Bill 1985 unsuccessfully attempted to introduce automatic disqualification where a director has been involved in more than one insolvent company. See Parry, "Personal Insolvency as a Restriction on Involvement in Company Management", [1999] *Insolvency Lawyer* 199 at 200

or indirectly, is concerned or takes part in the management of a company. The Act provides thus:

“Where a person is convicted of any offence in connection with the promotion, formation or management of a company; or in the course of a winding up a company it appears that a person has been guilty of any offence for which he is liable (whether he has been convicted or not under section 323); or has otherwise been guilty, while an officer of the company, of any fraud in relation to the company or of any breach of his duty to the company, the court may make an order that the person shall not, without leave of the court, be a director of or in any way, whether directly or indirectly, be concerned or take part in the management of the company for such period not exceeding five years as may be specified in the order.”<sup>36</sup>

The phrase "in connection with management" does not only refer to offences involving misconduct in the company's affairs, but includes the entire purpose for which the company exists.<sup>37</sup>

The provision is somewhat vague, as it is possible for a wide range of people, including employees in the lower cadre of the company, to be involved in indirect management. This makes it difficult for a disqualified person to ascertain what role he might assume once a company employs him.<sup>38</sup> For instance, since the concept of management involves policy-making and decision-making activities which affect the

---

<sup>34</sup> Hicks, *op cit* n 6, at 30.

<sup>35</sup> Disqualification arising from such grounds in some jurisdictions, such as Australia, is automatic. As such, a director, when applying for leave to act, bears the burden of proving why the order should not be made. For a detailed analysis on automatic disqualification see Australia's Corporations Act 2001, section 206 B; Hicks, "Making and Resisting Disqualification Orders", (1987) 8 Co Law 243.

<sup>36</sup> Section 189 (1).

<sup>37</sup> *R v Austen* (1985) 7 Cr App R 214. Since it is difficult to formulate a rule, which would adequately, cover all wrongdoing unrelated to the company, Drake argues that disqualification on such grounds should be reserved for the Articles. See Drake, "Disqualification of Directors-"The Red Card", [1989] JBL 474 at 477.

company as a whole, or a substantial part of it, and which may affect its financial standing,<sup>39</sup> a management consultant advising on financial management may be said to be concerned in the management of the company for the purposes of disqualification.<sup>40</sup>

As a result, full disqualification might not only remove a person from the board<sup>41</sup> but also make him unemployable.<sup>42</sup> Although a person may apply for a declaration or for leave to act, there can be no doubt that the slow and expensive judicial process would adversely affect directors who have been automatically disqualified.<sup>43</sup> Therefore such a broad disqualification is clearly inappropriate if it occurs automatically.<sup>44</sup>

### 8.2.3 *Fraud*

The Act provides for disqualification as a result of fraud. A court may disqualify a person from taking part in the management of a company if a person is "convicted of any offence in connection with the promotion, formation or management of a company."<sup>45</sup> A person can also be disqualified if, in the course of winding up of a company, it appears that he, while an officer of the company, has been guilty "of any fraud in relation to the company or of any breach of his duty to the company."<sup>46</sup>

In contrast to the Act, the Ghanaian Companies Code provides for disqualification on the basis of conviction of any offence (not necessarily relating to a company) involving fraud or dishonesty. The conviction need not be in Ghana. Similarly, Singapore, in 1967, adopted the Australian version of disqualification for criminal

---

<sup>38</sup> In *Re Altim Pty Ltd* [1968] 2 NSWLR 762 the applicant wanted leave of the court to be in charge of the New South Wales branch of a company making window frames. This was assumed to be a function of the management and the court refused to grant leave to take the job.

<sup>39</sup> *Commissioner for Corporate Affairs v Bracht* [1989] VR 821.

<sup>40</sup> *R v Campbell* [1984] BCLC 83.

<sup>41</sup> The Ghanaian Code imposes specific restrictions to prevent errant directors from being concerned in company management even when he is not a director. See section 186 (1) (b) Ghana's Companies Code.

<sup>42</sup> Where disqualification does not disqualify a director from serving a corporation as an employee, it cannot be said to have the effect of taking their livelihood away. See Leigh, "Disqualification Orders in Company and Insolvency Law", (1986) 7 Co Law 179 at 183.

<sup>43</sup> Automatic disqualification may be justified in cases of personal insolvency and criminal offences. See Hicks, op cit n 6, at 41.

<sup>44</sup> Automatic disqualification was rejected in England and Singapore. See Hicks, op cit n 6, at 41.

<sup>45</sup> Section 189 (1).

<sup>46</sup> Section 189 (1) (b) (ii).

offences<sup>47</sup> to cover not only offences in connection with the promotion, formation or management of corporations, but also offences involving fraud or dishonesty not connected with the company, where the maximum penalty is more than three months imprisonment, whether imposed or not.

Sufficient grounds, rather than mere allegation of fraud, need to be established in order to prove fraud under the Act. The onerous duty of proving fraud was illustrated in the case of *Kassam Ebrahim v Tait*<sup>48</sup> where the Official Receiver applied under section 196 of Uganda's Companies Ordinance<sup>49</sup> for the public examination of company directors, Kassam Ebrahim and Mohamedali Damji. The company, Kassam Ibrahim & Co Ltd, was incorporated for the purposes of taking over a business formerly carried on in partnership involving the two directors. The Official Liquidator alleged that the partnership was insolvent at the time that the company was formed. The liquidator therefore sought to have a public examination of the directors on the basis that the incorporation was fraudulent on the creditors of the company. He also sought to recover two sums of money that were said to have been received by the directors from the company, and to hold them personally liable for the debts of the company. Finding that the Official Receiver had failed to prove fraud, Law CJ followed the judgement of Lord Halsbury in *Ex parte Barnes*,<sup>50</sup> which provided that:

"In order to give the Court jurisdiction to make such an order, there must be a finding of fraud, and a finding of fraud against an individual who is thereby made subject to being summoned before the court.... I do not mean that the particular word 'fraud' must be used, but that such facts must be found by the Official Receiver as suggests fraud against the person incriminated: and that there must be an individual person incriminated: it is not enough that there is a general

---

<sup>47</sup> Singapore Companies Act, section 154.

<sup>48</sup> [1935] EACA 51.

<sup>49</sup> Cap 105.

<sup>50</sup> [1896] AC 146.



finding that fraud must have existed somewhere, which would mean nothing." <sup>51</sup>

A reason that influenced the opinion of Law CJ concerning the fact that the Official Receiver had not proved fraud was that the money received, by Kassim Ebrahim, from the company as part of the purchase price of his interest in the partnership business did not raise any suspicion. Moreover, the Receiver did not show when the sum was received, what the capital of the company was, and how the formation of the company constituted fraud on the creditors.<sup>52</sup>

As a result of the onerous burden of proving fraud in Kenya, disqualification, only on grounds of fraud when a company is a going concern, might be insufficient to ensure commercial propriety and foster an appropriate business environment. This reason led the UK's Cork Committee to favour disqualification based on the wrongful acts of directors rather than fraud.<sup>53</sup> Thus, section 214 of the Insolvency Act followed as a result of the recommendations of the Committee. A director therefore becomes liable for the wrongful trading of the company where the company has gone into insolvent liquidation and at some time before the commencement of the winding up of the company the director knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation. A liquidator may apply to court for a declaration that a person who is or has been a director is liable to make a contribution to the assets of the company.<sup>54</sup> However, it is a defence for a director to show that he took every step with a view to minimising the potential loss to the creditors of the

---

<sup>51</sup> [1896] AC 146 at 152.

<sup>52</sup> [1935] EACA 51 at 57.

<sup>53</sup> Section 188 of the UK's Companies Act 1948 gave courts the power to disqualify a director following conviction for fraud in the operation of a company. This was widened by the Companies Act 1976, section 28 (1) which allowed disqualification for persistent default. Section 3 of the Companies Act 1981 extended the provision further by empowering the making of disqualification orders to liquidators, receivers, and managers of the property of a company. All the provisions were consolidated in the Companies Act 1985, section 300, which preceded the Company Directors Disqualification Act 1986. Although a director had to be associated with two successive insolvencies before he could be disqualified under section 300, he may now be disqualified under section 6 of the 1986 Act if the court is satisfied that he has been a director of a company which has at any time become insolvent (whether while he was a director or subsequently) or that his conduct as a director of that company makes him unfit to be concerned in the management of a company.

<sup>54</sup> Section 214, Insolvency Act 1986.

company. A disqualification order may also be made against a director found liable for wrongful trading.<sup>55</sup>

It is not possible for a director to be disqualified in Kenya unless he been convicted of any offence in connection with the promotion, formation, or management of a company; or the company is in the process of being wound up and it appears that a director is guilty of any fraud or breach of duty in relation to the company.<sup>56</sup> This provision renders it impossible to disqualify directors for breach of duties when a company is a going concern. Thus, broadening the scope of section 189 (1) to provide for disqualification arising from breaches of duty when a company is a going concern would make it more of a deterrent. This may be achieved by disqualifying directors on the basis of their unfitness to act in the management of companies, a ground which is applied in the UK. This ground of disqualification is considered in the following section.

#### **8.2.4 Unfitness**

A director in Kenya cannot be disqualified<sup>57</sup> for being unfit to be involved in the management of a company. Thus, whilst breach of duty is a sufficient ground for disqualification if a company is in the course of winding up,<sup>58</sup> fraud needs to be proven for a director to be disqualified when the company is a going concern.<sup>59</sup> In contrast, a director in the UK can be disqualified under section 8 of the CDDA for being unfit<sup>60</sup> when the company is a going concern. *The Secretary of State can make an application under this section for a disqualification order where it appears to him, from an Inspector's report, that it is necessary in the public interest to have the director declared unfit. In such an event the court can exercise its discretion to make a disqualification order where it is satisfied that the conduct of a director in*

---

<sup>55</sup> Section 10, CDDA.

<sup>56</sup> Section 189 (1) of the Act

<sup>57</sup> Section 6 of the CDDA obliges the court to make a disqualification order against an individual if it is satisfied that he is or has been a director of a company which has become insolvent and that his conduct as a director of that company makes him unfit to be concerned in the management of a company.

<sup>58</sup> The Act, section 189 (1) (b) (ii).

<sup>59</sup> Section 189 (1).

<sup>60</sup> In determining whether a director is unfit under both sections, section 9 obliges the courts to have regard to matters mentioned in Part I of the schedule I. In case the company has become insolvent, the court must have regard to matters mentioned in part II of schedule 1.

relation to the company makes him unfit to be concerned in the management of a company.

In the UK, the CDDA makes it compulsory for a judge to make an order, under the unfitness ground, if the terms of the legislation are satisfied.<sup>61</sup> For a director to be declared unfit, the court must be satisfied that the director has exhibited gross incompetence or conduct in breach of commercial morality that constitutes a danger to the public.<sup>62</sup> This may arise, for instance, where a director conducts business in total disregard of the interests of creditors. In *Re Ipcon Fashions Ltd*<sup>63</sup> knowledge by the director that the company was insolvent when he siphoned off its business to another company, incurring liability to the old company, was held to be a ground for disqualification. Similarly, in *Re McNulty's Interchange Ltd*<sup>64</sup> a director who had no new ideas about improving the business of a company, which was continuously accumulating debts, was liable for disqualification.<sup>65</sup> Explaining what makes a person unfit in the UK, Browne Wilkinson VC said in *Re Lo Line Electric Motors Ltd*:

"Ordinary commercial misjudgement is in itself not sufficient to justify disqualification. In the normal case, the conduct complained of must display a lack of commercial probity, although I have no doubt that in an extreme case of gross negligence or total incompetence disqualification could be appropriate."<sup>66</sup>

---

<sup>61</sup> Section 6-9.

<sup>62</sup> Per Hoffmann J in *Dawson Print Group Ltd v Princo Ltd* (Unreported, 9 April 1986, ChD). In assessing unfitness the court, by virtue of section 6 (1) (b) considers the conduct of the director in relation to that company and any other company or companies. For more details see Hicks, op cit n 6, at 33.

<sup>63</sup> (1989) 5 BCC 733

<sup>64</sup> (1988) 4 BCC 533

<sup>65</sup> In *Re Douglas Construction* (1988) 4 BCC 553 a director had put a lot of his own money into the company in order to keep it going and was held not to have contravened the principles of business morality. Hoffmann J in *Dawson Print Group Ltd v Princo Ltd* (Unreported, 9 April 1986, ChD) found a director not liable for failing to pay debts due to the Crown and continuing to trade when he ought to have known that the company was insolvent. This was different from the judgement of Vinelott J in *Re Stanford Services Ltd* (The Times, 29 April 1987) where he rendered the commercial test unhelpful and disqualified a director for two years for using money collected as VAT or PAYE as part of their cash flow needs.

<sup>66</sup> [1988] Ch 477 at 486.

The courts have, therefore, refused to disqualify directors for mere mismanagement, as the aim of disqualification is the protection of the public and not punishment of directors.<sup>67</sup> It therefore follows that despite the mandatory nature of section 6 of the CDDA, the courts may decline to disqualify a director in the absence of sufficient evidence to prove unfitness.<sup>68</sup> Although the courts assess whether a director should be disqualified on the balance of probabilities, the amount of evidence required to find a director liable is often more onerous than that,<sup>69</sup> as the evidence required extends the standards of proof beyond the civil one. Given that the application of the balance of probabilities test would lead to disqualification of many directors, the onerous standard of proof is thus applied in favour of directors so as to ensure that they continue to run companies where risk is not apparent.<sup>70</sup>

While assessing unfitness, the courts examine the role of directors in making the company insolvent. For instance, the failure to provide goods and services which have already been paid for, giving preference to one group of creditors over another,<sup>71</sup> or entering into a transaction at an undervalue would be pointers to unfitness.

#### **8.2.4.1 Incompetence**

In Australia, a disqualification order can be made where a director acts dishonestly or fails to exercise reasonable care.<sup>72</sup> As such, a conviction is not a prerequisite for a disqualification order. The courts and the Australian Securities and Investments Commission require the respondent to show why he should not be disqualified.<sup>73</sup> This involves assessing matters of incompetence or breach of duty. Similarly, in

---

<sup>67</sup> Per Henry LJ in *Re Grayan Building Services Ltd* [1995] BCC 554, at 577.

<sup>68</sup> In *Re Arctic Engineering Ltd (No 2)* [1986] BCLC 253 persistent defaults by an accountant in making necessary returns did not result in disqualification since there was no dishonesty.

<sup>69</sup> Laddie J in *Re Living Images Ltd* [1996] 1 BCLC 348 favoured the view that the evidence against a director ought to be overwhelming rather than indicative of the directors' wrongdoing.

<sup>70</sup> Griffin, "Standards of Proof Applicable to S 6 of the Company Directors Disqualification Act 1986" (1997) 18 Co Law 24 at 25; Hoey, "Disqualifying Delinquent Directors" (1997) 18 Co Law 130 at 132.

<sup>71</sup> Paying only those creditors who pressed for payment and taking advantage of those who did not in order to provide the working capital has been held to amount to unfitness. See *Re Sevenoaks Stationers Retail Ltd* [1991] Ch 164 (CA).

<sup>72</sup> Section 206F (1) (c) empowers the Australian Securities and Investments Commission to disqualify a person from managing corporations for up to five years if the Commission is satisfied that disqualification is justified.

<sup>73</sup> For UK, see section 8 of the Company Directors Disqualification Act 1986.

New Zealand a disqualification order can be made in a case where a director has acted in a reckless and incompetent manner.<sup>74</sup>

In the UK, the Jenkins Report of 1962<sup>75</sup> proposed that directors ought to be disqualified if they had acted in an improper, reckless or incompetent manner in relation to the affairs of a company.<sup>76</sup> Although it was argued that this proposal was excessive on the basis that the standard required to prove recklessness and incompetent behaviour is not as high as that for proving unfitness, the test is used in the assessment of unfitness following insolvent liquidations which involves consideration of questions of commercial incompetence.<sup>77</sup>

In assessing both recklessness and incompetence,<sup>78</sup> courts pay attention to the need to allow directors to take commercial risks. For instance, seeking and acting on competent outside advice<sup>79</sup> in the event of financial difficulties<sup>80</sup> is evidence of competence even when the advice does not forestall the insolvency of a company.<sup>81</sup> Given that directors would always be found liable for negligence if any collapse of business was treated as evidence of negligence, consideration of the risks they take gives them room to manage companies without interference.<sup>82</sup>

Although breach of duty is a sufficient ground for disqualification when the company is in the course of winding up in Kenya, the unfitness ground in the UK is

---

<sup>74</sup> New Zealand's Companies Act 1993, section 383.

<sup>75</sup> Report of the Company Law Committee, June 1962, Cmnd 1749, paras 80, 85.

<sup>76</sup> The Report had proposed that a series of insolvent liquidations would be a pointer. See Hicks, *op cit* n 6, at 43.

<sup>77</sup> For a detailed analysis see, S Griffin, *op cit* n 1, p 171.

<sup>78</sup> *Ibid*, p 169.

<sup>79</sup> Although the CDDA was effective in dissipating public dissent in respect of directors misconduct, it has been criticised for discouraging the best directors from assuming directorships and usage of company expenses by directors to hire expensive professional advisers, rather than attempting to solve the problem, to the detriment of shareholders and creditors. See BR Cheffins, *Company Law, Theory, Structure, and Operation* (Clarendon Press, 1997) p 552; B Pettet, *Company Law* (Pearson Education, 2001) p 453; Hicks, "Advising on Wrongful Trading: Part 2" (1993) 14 Co Law 55 at 58.

<sup>80</sup> In the event of disqualification arising after liquidation of a company, it is the creditors who bear the costs of disqualification proceedings as the office holder in charge is paid out of the company's assets in priority to all other claims. Despite not benefiting from directors' disqualification, creditors are made to bear such costs. Where directors contest disqualification orders a great deal of legal expenses are to be expended. See CDDA, section 7 (3), Insolvency Act 1986 section 115.

<sup>81</sup> *Re Douglas Construction Services Ltd* [1988] BCLC 397.

<sup>82</sup> Davies PL, *Gower's Principles of Modern Company Law*, (6th ed, Sweet & Maxwell, 1997) p 686. In *Re Richborough Furniture Ltd* [1996] 1BCLC 507 a director was disqualified for three years for lack of experience, knowledge, and understanding.

more appropriate, as it is wider. For instance, the company does not have to be in the course of winding up for the unfitness ground to be applied. The unfitness ground also introduces a desirable application of objective standards,<sup>83</sup> such as breach of commercial morality, gross incompetence, recklessness, and being a danger to the public, by which to judge the conduct of directors.<sup>84</sup> Therefore, whilst a director who fails to monitor and supervise delegated activities would escape liability for being judged subjectively in Kenya, he can be disqualified on the ground of unfitness in the UK.<sup>85</sup> The application of objective standards has, in effect, raised the standards of skill and care in the UK.<sup>86</sup>

The provisions in Singapore, UK, and Australia therefore adopt a wider scope than that of the Act. The fact that the Singapore and Australian Acts disqualify directors automatically without requiring a disqualification order from the court makes the enforcement easier by speeding up the disqualification process. The onus is usually on the disqualified person to apply to court for leave to direct a company.<sup>87</sup>

#### **8.2.5 Filing Returns**

In Kenya, whilst the failure to file annual returns by a director makes a director liable to a fine,<sup>88</sup> it is not a ground for disqualification. However, in the UK<sup>89</sup> and Australia<sup>90</sup> the courts can disqualify a director for up to five years for being in default of filing returns with the Registrar of Companies. Although the failure to comply with the reporting requirements of legislation, such as failure to file annual accounts, produce audited accounts, and to keep proper accounting standards, is a separate ground for disqualification in the UK, it is also an indicator of unfitness. A director is liable to disqualification under this section if breaches occur

---

<sup>83</sup> The application of objective standards is illustrated in *AB Trucking and BAW Commercials* (Ch D June 1987, Unreported) where the respondent was said to be incapable of understanding the commercial reality of accounts and thus incapable of discharging his duty to the public. Harman J disqualified the respondent for four years for falling below an objective standard. See Dine, "Disqualification of Company Directors" (1988) 9 Co Law 213.

<sup>84</sup> For a detailed analysis of the standards see Dine, "Disqualification of Company Directors" (1988) 9 Co Law 213; *Dawson* [1987] BCLC 601; and *Re Stanford* [1987] BCLC 607.

<sup>85</sup> *Re Barings Plc (No.5)* [1999] 1 BCLC 433.

<sup>86</sup> *Re D'Jan of London Ltd* [1994] 1 BCLC 561, per Hoffmann LJ. See also Walters, "Directors' Duties: The Impact of the CDDA of 1986" [2000] 21 Co Law 110.

<sup>87</sup> Hicks, *op cit* n 6, at 33.

<sup>88</sup> Section 125 (3), The Act.

<sup>89</sup> Section 3, CDDA 1986.

<sup>90</sup> Corporations Act 2001, sections 4, 10, 285.

persistently.<sup>91</sup> In contrast to the UK provision, the Australian provision captures a wider scope, as it covers all breaches of companies legislation, rather than only those dealing with the filing of returns or other documents.

Given that disqualification under this head improves the level of compliance in filing, it raises the accountability of directors to shareholders because shareholders and others are able to keep track of the affairs of the company. It is, therefore, to be supported for inclusion in the Act.

### 8.3 The Length of disqualification orders

Under section 189 a disqualified director is prevented from being involved in the management of companies for a period not exceeding five years. Other jurisdictions have recognised the need for longer periods of disqualification. For instance, Australian courts can disqualify a person from managing corporations for a period that the Court considers appropriate.<sup>92</sup> The UK's CDDA imposes a minimum disqualification for unfitness of two years and a maximum of fifteen years.<sup>93</sup>

The Nigerian Law Reform Commission of 1987 recommended that directors who have been convicted of company related offences or any other offences should be disqualified for a mandatory ten years after conviction.<sup>94</sup> Five years disqualification after conviction was found to be too lenient. The Nigerian Commission rejected the Jenkins'<sup>95</sup> proposals to the effect that a person who has persistently failed to comply with the Act should be disqualified for a further five years after release from prison, on the basis that it was excessive and could therefore deter even the best people from accepting directorships. The Commission also recommended the broadening of the scope of the persons disqualified to include infants less than 18 years.<sup>96</sup>

---

<sup>91</sup> Breaches are said to occur persistently if it is shown that a person has been convicted in more than three instances within five years for failing to provide information. See s 3 (2) and (3), CDDA 1986; *Re Arctic Engineering Ltd* [1986] 1 WLR 686.

<sup>92</sup> Corporations Act 2001, section 206C and 206 E.

<sup>93</sup> Under Section 6, CDDA. In assessing the appropriate length of the disqualification order, the court considers: the nature of the offence, whether it was closely connected with management, the nature of the person's involvement in the offence, his general character and reputation etc. See Hicks, *op cit* n 35, at 246.

<sup>94</sup> Nigeria Law Reform Commission, *Working Papers on the Reform of Nigerian Company Law*: Volume 1-Review and Recommendations, 1987 p 184.

<sup>95</sup> Report of the Company Law Committee, June 1962, Cmnd 1749, paras 80, at 85.

<sup>96</sup> Nigeria Law Reform Commission, *op cit* n 94, p 184. Section 186 (1) of the Act imposes the age of 21 as the minimum age for appointment.

Furthermore, it took the view that it was necessary to utilise a mandatory disqualification on the basis that a discretionary one could still enable fraudulent directors to find their way to boards with the consent of the courts.<sup>97</sup>

Given that there are many directors who are involved in repeat offences, the period of disqualification of five years is insufficient.

#### **8.4 Procedure for Disqualification**

In Kenya, application for a disqualification order can be made by the Official Receiver, liquidator of the company or by a person who is or has been a member or creditor of the company.<sup>98</sup> Enabling creditors and members to make applications for disqualification enhances the process for the disqualification of miscreant directors, especially where the Attorney General would not otherwise take action due to lack of independence. However, given that the ability of creditors and members to make an application might be constrained by lack of financial resources, a public independent body might protect their interests more effectively.

In the UK, the court may make a disqualification order under the following circumstances: where a person is convicted of an indictable offence “in connection with the promotion, formation, management, or liquidation of a company”;<sup>99</sup> for persistent breaches of companies legislation;<sup>100</sup> for fraud in the course of winding up;<sup>101</sup> and where a person is convicted for failure to comply with the companies legislation.<sup>102</sup> The Secretary of State is empowered to make an application for disqualification.<sup>103</sup> However, if the company in question is in compulsory liquidation, the Secretary of State may direct the Official Receiver to make the

---

<sup>97</sup> It also sought to incorporate Article 87 of Table A in relation to vacation of office. Article 87 provides for a director to vacate office if he does not take up his shares after the required period, when he becomes bankrupt, he becomes of unsound mind, he resigns, he is absent for more than six months without permission of directors. See Nigeria Law Reform Commission, *op cit* n 94, p 185.

<sup>98</sup> Section 189 (4).

<sup>99</sup> CDDA, Section 2 (1).

<sup>100</sup> *Ibid* section 3.

<sup>101</sup> *Ibid* section.

<sup>102</sup> *Ibid* section 5.

<sup>103</sup> Section 7 (1) (a).



application.<sup>104</sup> Similarly, the Australian Securities and Investments Commission can also apply to court for disqualification orders.<sup>105</sup>

The Ghanaian Code provides that such an application can only be made by the Registrar, Official Trustee, or by the liquidator of any body corporate. Professor Gower<sup>106</sup> recommended this measure in order to prevent malicious applications. Although the adoption of such a provision in Kenya might curb malicious prosecution to some extent, it is also possible for the provision to restrict the number of persons who institute proceedings to the detriment of creditors. Since government interference in the duties of public officials is not uncommon, there is a danger of fewer cases being brought to court if the scope of persons who can apply is not widened.<sup>107</sup>

In Kenya, the Registrar, as an official in the office of the Attorney General, is less likely to enforce the disqualification provisions due to political interference.<sup>108</sup> Given that the Attorney General is a member of Cabinet, he rarely acts independently despite the existing constitutional guarantees which safeguard his independence. In the past, this has clearly been illustrated by several cases.

First, the fact that the Parliamentary Public Investments Committee has questioned the Attorney General over an alleged failure to prosecute persons named in corrupt deals lends credence to lack of independence on his part.<sup>109</sup>

---

<sup>104</sup> Section 7 (1) (b). The UK's Cork Committee (Report of the Review Committee on Insolvency Law and Practice, Chairman Sir Kenneth Cork, Cmnd 8558 (1982) recommended that apart from Secretary of State and the Official Receiver, liquidators and creditors should be permitted to make applications, as limiting the applications to the Insolvency Service was considered inadequate due to the fact that the Service might not have enough information about directors, especially when the company is wound up voluntarily and therefore the Official Receiver is not involved. Although liquidators, administrators and receivers are required to report to the Secretary of State on the conduct of directors, the quality of information is not always of the right quality. Another factor that would affect the effectiveness of Insolvency Service is the quantity and quality of resources utilised to enforce the provision.

<sup>105</sup> Under the Corporations Act 2001, ASIC may apply for disqualification of a person: for contravening a civil penalty provision (section 206C), "if within the last 7 years, the person has been an officer of 2 or more corporations when they have failed" (section 206D) etc.

<sup>106</sup> He drafted the Final Report of the Commission of Enquiry into the Working and Administration of the Present Company law in Ghana, 1961.

<sup>107</sup> Leigh, "Disqualification Orders in Company and Insolvency Law" (1986) 7 Co Law 179 at 182.

<sup>108</sup> "Anti-Corruption, Economic Crimes Bill Debate Rages", *East African Standard*, 21 July, 2001 and "A-G in Spotlight for Sloppy Drafts", *East African Standard*, 25 July, 2001.

<sup>109</sup> Op cit n 14.

Secondly, as mentioned in Chapter Three, the Attorney General was reluctant to prosecute those implicated in the Goldenberg fraud despite the fact that the Government lost \$ 400 million in public funds to Goldenberg International Ltd, trading gold and diamonds that Kenya does not produce.<sup>110</sup> Although some directors have been prosecuted, some senior government officials in charge of the Ministry of Finance and the Central Bank have not been investigated.<sup>111</sup>

Thirdly, the Ninth Report of the Public Investments Committee recommended that the Registrar of Companies should be dismissed over a transaction in which the former Kenya Posts and Telecommunications (KPTC) irregularly lost 6, 569, 345 Kenyan Shillings (£65, 693). The Registrar was accused of failing to avail himself of information on the transaction in which KPTC bought 196 maisonettes at 64, 680,000 Kenyan Shillings (£646, 800) and then sold them for the same amount to the Office of the President six years later. The failure on the part of the corporation to include an amount of 6, 569, 345 Kenyan Shillings (£65, 693) in respect of legal fees led to a direct loss of the same amount to the corporation.<sup>112</sup>

Fourthly, the lack of political will on the government to enforce disqualification provisions can also be discerned from a recent proposal by the Attorney General which sought to grant amnesty to individuals who had committed economic crimes before December 1, 1997. The implementation of the proposal, which is contained in the Anti-Corruption and Economic Crimes Bill 2000, would have grave implications on corporate governance, as companies would not be able to recover money from miscreant directors.<sup>113</sup> Besides, some cases, which are pending in court, against directors would come to an end.<sup>114</sup>

---

<sup>110</sup> Investigative series by Sarah Elderkin in the *Daily Nation*, 30 July - 6 August, 1993.

<sup>111</sup> Holman & Wrong, "Moi Weighs Tough Corruption Probe", *Financial Times*, 28 July, 1997.

<sup>112</sup> "PIC Unearths Massive Sh 673m Fraud at KPA" *East African Standard*, 38, 2000.

<sup>113</sup> Although the Bill undermines the conditions of the donor institution conditions to the Government, IMF supported the Bill. See "Amnesty Proposal Angers Opposition" *Sunday Standard*, July 15, 2001.

<sup>114</sup> According to the Bill, the amnesty would not apply to persons who were under investigations or were prosecuted by the former KACA, the A-G or the police for corruption related offences prior to December 22, 2000. It was also not meant to apply in the cases of offences committed by persons who were not in Kenya or against whom a warrant of arrest was outstanding on December 2000. See "Amnesty Proposal Angers Opposition", *East African Standard*, 15 July, 2001.

The fact that the Attorney General favoured the granting of amnesty to errant persons rather than investigating the offences and subsequently seeking the disqualification of those, for instance, responsible for companies' fraud is a clear indication of the interests that he protects. However, in spite of the possible drawbacks that might arise as a result of the implementation of the amnesty clause, the clause might also have some considerable benefits. First, given that the prosecution of past economic crimes might take many years to finalise, the implementation of the amnesty clause would enable the courts to deal more effectively with present economic crimes.<sup>115</sup> Second, the clause might jump-start the transition process by making politicians less apprehensive of losing power and wealth as a result of a comprehensive reform of the law and less likely to try to cover up the past.<sup>116</sup> As Rev. Musyimi states:

“as long as fear of future prosecution or other troubles related to past abuses consumes significant players in Kenya’s current political elite, their willingness to effect and/or allow a smooth political transition is limited.”<sup>117</sup>

### 8.5 Enforcement of Disqualification Orders

The implementation of a disqualification framework would hardly be effective without reliable enforcement mechanisms. To satisfy the objectives of disqualification orders, the Act makes a disqualified person who gets involved in the management personally responsible for the debts of the company incurred while he was so involved. The responsibility attaches where it appears in the course of winding up that any business of the company has been carried on with intent to defraud creditors of the company or for any fraudulent purpose.<sup>118</sup>

<sup>115</sup> The Attorney General reckons that it would take between ten and twenty years to work through past economic crimes. See Ochieng, "Call for Amnesty Team on Graft and Clashes", *Daily Nation*, 2 August, 2002; Wachira, "Repent, Amnesty Seekers are Told", *East African Standard*, 2 August, 2002.

<sup>116</sup> The initiatives of the Truth and Reconciliation Commission in South Africa enhanced the political transition process.

<sup>117</sup> Rev Musyimi, "Towards National Reconciliation in Kenya", Address given to Transparency International-Kenya Open Forum on Whether Kenya should be Thinking of an Amnesty for Economic Crimes, on 26 April, 2001, at Norfolk Hotel Ballroom.

<http://www.tkenya.org/documents/RevMutavaMusyimiSpeechOnAmnesty.doc>

<sup>118</sup> Section 323 (1). In the UK, a person who acts or who is willing to act on the instructions of a person he knows to be disqualified can also be disqualified under section 15, CDDA. Section 214 of the UK Insolvency Act 1986 gives the court a discretion to declare, on the liquidator's application,

### 8.5.1 *Limited and Conditional Orders*

The Act does not make provision for limited and conditional orders. The courts therefore either impose absolute disqualification orders or make no disqualification orders. Limited and conditional orders may be useful in instances where the courts feel that it may, for instance, be appropriate to disqualify a director from a public company and not a private one<sup>119</sup> in order to safeguard commercial interests.<sup>120</sup> Therefore, where damage to the company is not apparent, conditional disqualification orders are useful because they allow the courts to balance the interests of the public, employees and the director in question and, in turn, encourage enterprise and protect creditors at the same time. Thus, where the courts are reluctant to impose absolute disqualification due to their harsh consequences, they might be far more amenable to making limited and conditional orders. For instance, the UK courts can give directors leave to act under certain circumstances.<sup>121</sup> It is possible for the leave to act to be utilised as a limited disqualification order where a director is allowed to serve in certain capacities only.<sup>122</sup> Similarly, Australian courts may impose such conditions or limitations as they think fit.<sup>123</sup> Thus, the courts can protect creditors effectively by use of conditional orders rather than the far-reaching absolute disqualification orders.

---

that a director be liable to contribute to an insolvent company's assets where he is guilty of wrongful trading. This occurs when a director before the commencement of business knew or ought to have known that there was no reasonable prospect of avoiding insolvent liquidation and he failed to take every step to minimise potential loss to creditors. The court may also order disqualification for up to fifteen years. See Insolvency Act 1986, sections 213 -214; Hicks, op cit n 6, 46.

<sup>119</sup> Hicks, op cit n 6, at 42.

<sup>120</sup> In *Re Majestic Studios* [1989] BCLC 1, Morgan Davies J allowed a director to continue trading after a disqualification order on condition that he was accountable to an independent assessor. In so doing the court was able to save fifty jobs which were at risk.

<sup>121</sup> In *Re Lo-Line Electric Motors Ltd* [1988] 3 WLR 26 a director was disqualified for a three year period but permitted to remain as a director of two companies so long as a named qualified accountant remained a director of the company. In *Re Majestic Studios* [1989] BCLC 1, Morgan Davies J allowed a director to continue trading after a disqualification order on condition that he was accountable to an independent assessor. Such conditions are not different from the conditional orders given in other jurisdictions. See Hicks, op cit n 35, at 247.

<sup>122</sup> Hicks, op cit n 35, at 247.

<sup>123</sup> Section 206G (1) of the Corporations Act 2001 enables the courts to grant leave to manage "corporations, particular class of corporations or a particular corporation." Under Section 206G (2) the court determines the conditions and exceptions to accompany the leave. In *Re Magna Alloys & Research Pty Ltd* (1974-76) 1 ACLR 203 at 207 a person was given leave to take part in the management of three specified companies when their boards were controlled by independent non-executive directors. Similarly, in *Re Leomond Properties Pty Ltd* (1983) 1 ACLC 1370 leave to be a director of seven companies was given following conviction for handling stolen crucifixes. In *Re Minimix Industries Ltd* (1982) 1 ACLC 511 a New Zealand court gave a person leave to be a manager of a specified company so long as he would not be signing cheques on behalf of the company.

### 8.5.2 Undertakings

In view of the delay of proceedings in the Kenyan courts, Kenya might need to adopt a disqualification regime that does not clog up the court system. The adoption of undertakings by directors, for instance, would enable disqualification proceedings to be settled without reference to the courts. The directors would undertake not to be involved in the management of companies for a specific period of time. Such undertakings have already been adopted in the UK. The Insolvency Act 2000 empowers the Secretary of State to accept the undertaking of a director without requiring him to admit the actual basis of disqualification. While such undertakings might be expedient and cheaper on the public purse, they might pose a problem in that directors might accept a period of disqualification to avoid the cost burden for defending disqualification proceedings.<sup>124</sup> Besides, the Insolvency Service might be tempted to accept undertakings in order so as to achieve the policy objective of disqualifying many directors.<sup>125</sup>

### 8.5.3 Register of Disqualified Persons

Whilst Kenya has no provision for a register of disqualification orders, the Ghanaian Code requires the Registrar to publish a register of disqualified persons in the Gazette and maintain it for the purposes of public inspection.<sup>126</sup> Similarly, the UK Secretary of State maintains a register of disqualification orders,<sup>127</sup> which is open to inspection free of charge.<sup>128</sup> The register can be inspected at Companies House in London within fourteen days of making a disqualification order. The court sends the particulars of the order to the Secretary of State for entry in the register. In addition, any variation and grant of leave to act must be communicated to the Secretary of State.<sup>129</sup> Similarly, section 243 of the Australian Corporations Law requires the

---

<sup>124</sup> Walters, "Directors Disqualification: The Vice-Chancellor's Address to the Chancery Bar Association" (2000) 21 Co Law 90.

<sup>125</sup> Walters, "Bare Undertakings in Directors Disqualification Proceedings: The Insolvency Act 2000, Blackspur and Beyond", (2001) 22 Co Law 290 at 297.

<sup>126</sup> Section 186 (7) provides that "where any order is made or leave is granted under this section the court making the order or granting leave shall forward a copy to the Registrar who shall cause a summary thereof to be published in the Gazette. The Registrar shall maintain a register of orders made under this section and shall enter thereon particulars of each order and any leave granted and such register shall be open to the inspection of any person."

<sup>127</sup> This was introduced in the UK by the Companies Act 1976.

<sup>128</sup> Section 18, CDDA 1986. Similar provisions exist in Australia see section 1274AA, Corporations Act 2001.

<sup>129</sup> S Mayson, *op cit* n 30, p 727.

Australian Securities and Investments Commission to keep a publicly available register of disqualified company directors.

In Kenya, as there is no publication, it is not possible to enforce disqualification orders adequately, as a director might secretly continue to act. To ensure effective enforcement of disqualification orders, there is need to publicise the orders given by the courts.

## **8.6 Conclusions**

The disqualification regime in Kenya fails significantly to deter directors who might be tempted to engage in activities that are detrimental to the well-being of a company. Although the present provisions do provide for disqualification of directors, they are not as effective as they might be. Some provisions in the other jurisdictions discussed above are clearly more stringent than the Act. Kenya needs to broaden the scope of provisions, offences, and grounds covered by the Act in order to prevent errant directors from finding their way to boardrooms, and to stamp out corruption.

The disqualification framework only enables a director to be disqualified on the basis of fraud when a company is a going concern. Thus, a director cannot be disqualified on the basis of breach of duty, unfitness, and failing to file returns. A director can only be disqualified, under section 189, for breach of duty when a company is in the course of winding up. This does little to raise the standards of the conduct of directors and to protect the public from miscreant directors. This provision would be more of a deterrent if it also covered unfitness of directors when the company is a going concern.

Although creditors and shareholders can make applications for disqualification,<sup>130</sup> their interests might be compromised when their financial resources are constrained. This problem might be resolved by establishing a publicly funded body with the mandate to make such applications. The body ought to be independent from the political establishment so as to be effective.

A public register of disqualification orders would offer more protection to creditors and the general public because they would be in a position to register their protest where a disqualified person manages companies. The use of limited or conditional disqualification orders by the courts as opposed to absolute prohibition would serve directors well because they would give courts some flexibility, which would protect both the interests of the creditors and commercial interests.

Whilst broadening the scope of disqualification would go a long way to regulating directors more effectively, it is worth noting that some stringent provisions, such as automatic disqualification, might punish directors far too much in spite of their usefulness to creditors.

---

<sup>130</sup> s 189 (4).

## CHAPTER NINE

### 9.0 EMPIRICAL STUDY

#### 9.1 Introduction

A survey conducted by the International Chamber of Commerce between 1999 and 2000 indicated that foreign ventures by multinational corporations were likely to increase in Africa in the following three to five years.<sup>1</sup> According to the survey, Kenya was not one of the most favoured markets.<sup>2</sup> The most favoured were South Africa, Egypt, Morocco, Uganda and Nigeria.<sup>3</sup> In the past, some companies have objected to entering into the Kenyan market due to its regulatory framework. For instance, Vodafone Airtouch only entered into the Kenyan market after Safaricom (Kenya), its commercial partner, was exempted from the State Corporation Act.<sup>4</sup> Initially, Vodafone Airtouch feared that the State Corporations Act would hamper its effectiveness,<sup>5</sup> as it gives the government immense powers to run corporations.<sup>6</sup> Thus, the current regulatory framework in Kenya appears to be a disincentive for investments.<sup>7</sup>

It is against this backdrop that a survey was conducted between October 2001 and January 2002 in Nairobi to establish what views exist in Kenya concerning the regulatory framework and whether aspects of the legal framework in Kenya need to

---

<sup>1</sup> The survey produced 63 responses from companies with 1.6 million employees abroad and foreign sales of US \$ 625 billion from their affiliates abroad alone. Only 3% of the responding companies were headquartered in Africa. In all, only 6% of the respondents said they plan to decrease their investments or pull out of Africa altogether. See Kassir, "Private Sector Growth is Good News out of Africa", *Journal of Commerce*, 23 March 2000.

<sup>2</sup> Akoko and Ondego, "Pfizer to Pull Out of Kenya", *Daily Nation*, 6 September, 2001.

<sup>3</sup> Nigeria and South Africa have reformed their company laws considerably. See Nigeria Law Reform Commission, *Working Papers on the Reform of Nigerian Company Law: Volume 1-Review and Recommendations*, 1987; South Africa, *The King Report on Corporate Governance*, 2001.

<sup>4</sup> Cap 446, Laws of Kenya.

<sup>5</sup> Kisero, "Vodafone's Bid for Shares in Safaricom Still Unclear", *Daily Nation*, 4 April, 2000.

<sup>6</sup> Commenting on the difficulties experienced by most African states in privatising their telecommunications industries, the World Bank country representative, Makhtar Diop, recently stated that few foreign investors would not be willing to put their money in markets where the government was still a service provider. See Akumu, "State Control Blamed for Problems in Privatising Telecoms Companies", *Daily Nation*, 8 March, 2002.

<sup>7</sup> The Nairobi Stock Exchange's Chief Executive, Kibuga Kariithi, in February 2000 attributed the failure to implement a Central Depository System to the absence of enabling legislation to make it work. He felt that putting in place the system would attract foreign investors, as it would eliminate



be changed. This Chapter analyses the data collected from the survey with a view to assessing whether the current regulatory framework for directors and companies has any general adverse effects on the performance of directors. The survey sought to identify problems in the regulatory framework for directors. It also sought to establish possible solutions to the problems that would, if implemented, facilitate commercial activity and therefore encourage economic growth, investment, and stability in Kenya. In general, the aim of the survey was to obtain some empirical evidence concerning many of the issues raised already in this study. The specific issues assessed by the survey are:

- the main factors that have contributed to the poor performance of companies in Kenya.
- the extent to which donations from the resources of companies contribute to their poor performance.
- whether companies would benefit from obliging directors to assume social responsibilities.
- whether the codification of English common law principles, which are applicable in Kenya,<sup>8</sup> would make the law more accessible and easier to understand.
- whether directors take their duties in relation to skill, care, and diligence seriously.
- whether the enforcement mechanism for shareholders is effective.
- the factors that have contributed to the poor performance of parastatals and the possible measures that might improve their performance.
- whether multinational corporations do have regard to responsibilities that they have to fulfil in other countries.
- whether self-regulation by directors would be more effective than the current statutory regulation.
- whether a non-statutory statement of the duties of directors would promote awareness.

---

paperwork in the transfer of ownership of the share certificate as evidence of title. See Akumu, "New NSE System to Cost \$2 Million", *Daily Nation*, 29 February, 2000.

<sup>8</sup> Section 3 (1) of the Kenya's Judicature Act permits the application of the common law and doctrines of equity in force in England as at 12<sup>th</sup> August 1897. However, decisions of English courts given after the reception date are not of binding authority in the courts of the territory, though they are

- whether foreign companies avoid doing business in Kenya due to the apparent weak corporate regulatory framework.
- whether miscreant directors are ever punished for their misconduct, how frequent disqualification orders are, and whether a stricter disqualification regime would deter miscreant directors.

## 9.2 The Empirical Data

The data for this research was collected through questionnaires and interviews. A questionnaire was sent in October 2001 to 200 individuals in Kenya. The range of persons questioned was broad and comprised of 102 directors, 38 advocates, 16 academics, 12 company secretaries, 10 economists, 4 Judges of the Court of Appeal, 4 stock brokers, 4 senior officials from the Attorney General's Chambers, 3 Members of Parliament, 3 auditors, and 4 senior officials from the Capital Markets Authority of Kenya and Nairobi Stock Exchange. Fifty-six responses were received (a response rate of 28 per cent). The responses were received from 18 directors, 17 advocates, 6 company secretaries, 3 economists, 2 Judges of the Court of Appeal, 2 auditors, 2 Members of Parliament, 1 official from the Attorney General's Chambers, 1 academic, 1 official from the Capital Markets Authority, and 1 stock broker. Two individuals did not indicate their profession.

Ten individuals were also interviewed in Kenya between January 7 and January 25, 2002. Interviewees 1 - 7 were advocates, interviewee number 8 was an academic, and interviewees 9 and 10 were directors.

Selection of the participants was made from the above persons in order to have a sample that represents individuals dealing, directly or indirectly, with the legal framework that regulates directors.

The questionnaire contained three sections. Section A and B asked the respondents to comment on governance issues that are likely to affect the performance of companies. In particular, Section A asked general questions relating to reasons for the poor performance of companies. The respondents were given a choice of four

---

entitled to the highest respect if the English law has not been subsequently modified. See Amollo, "Reviewing 100 years of common law in Kenya", (January 1999) *The Advocate* 16 at 17.

answers to each question. Section B listed several statements and asked the respondents to state whether they strongly agreed, moderately agreed, had no view, moderately disagreed, or whether they strongly disagreed with the statements. Finally, Section C invited the respondents to elaborate on any of their responses or comment on any other issues that they deemed important and appropriate.

The Chapter sets out each of the questions put, seeks to incorporate some comments made in section C and those obtained from interviews, and then provides some commentary on the results of the analysis.

**Question 1: Which of the following factors have led to the poor performance of companies in Kenya? (A) Outdated laws, (B) Weak economy, (C) Lack of an effective democratic political regime, (D) Gross mismanagement of companies (E) Other factors (Please specify)**

The first question was answered by 51 respondents. Ten per cent chose outdated laws, 29 per cent chose a weak economy, 25 per cent chose lack of a democratic political regime, and 36 per cent chose gross mismanagement of companies.

**Question 2: What is your view as to the significance of allowing company directors to make donations? (A) They assist in promoting certain purposes, such as charity and education, (B) They enhance the image of companies and the country as a whole, (C) They encourage corruption, (D) Other views (Please specify)**

This question was answered by 55 respondents. Forty-six per cent felt that donations promote certain purposes such as charity and education. Fifteen per cent took the view that donations enhance the image of companies and 39 per cent felt that they encourage corruption.

**Question 3: Directors breach their duties because (A) The Companies Act is bulky and therefore difficult to understand, (B) Important common law principles are not codified in the statute, (C) They engage in competition with their companies, (D) Other reasons (Please specify)**

The question was answered by 38 respondents. Thirty seven per cent said that it is because the Act is bulky and therefore difficult to understand, 39 per cent felt that it

is because important company law principles are not codified in the statute, and 24 per cent attributed it to the competition that directors have with their companies.

Comments made in Section C in relation to the foregoing issues indicated that the Act ought to be revised in order to reflect social and economic changes in the country. It was also confirmed that the government has been reluctant to reform the Act.

Interviewee number 6 attributed abuse of duties to "a lot of technicalities in the Companies Act making it possible for a rogue director to hide behind the same."<sup>9</sup> Other factors, according to this interviewee, contributing to the poor performance of companies were noted as corruption, patronage, lack of ethics, state involvement in the running of companies, *multiple directorships, poor role models, the practice of* "stage managing" annual general meetings, insider loans that are not serviced, nepotism in recruitment, and an *ineffective judiciary which contributes to undue* delays in the courts. Interviewee number 3 also noted that "short term and immediate personal benefits cloud the long term objectives of the company and the economy as a whole, especially for the publicly quoted companies."<sup>10</sup>

With regard to donations, interviewee number 4 felt that they are not always useful, as they are prone to abuse. He attributed the insolvency of one company to political donations. He also averred that *it is the person making the donations, rather than the* company, who gets the credit. As such, he stated "such an action should only be done with the approval of the shareholders and where a ceiling has been set of how much the director can take towards such a purpose."<sup>11</sup>

Interviewee number 8 stated that "there is a need to have accountability in the public sector for there to be accountability in the private sector."<sup>12</sup> He observed that directors might be compelled to engage in corrupt practices in order to gain access to a market that is controlled by corrupt public officials. Interviewee number 10<sup>13</sup>

---

<sup>9</sup> Interview conducted on 23 January, 2002 in Nairobi.

<sup>10</sup> Ibid, 11 January, 2002.

<sup>11</sup> Ibid, 18 January, 2002.

<sup>12</sup> Ibid, 22 January, 2002.

<sup>13</sup> Ibid, 18 January, 2002.

confirmed that political interference with the operation of companies is common in both parastatals and the private sector.

### **Commentary**

It is evident from questions 1 to 3 that most of the respondents felt that companies performed poorly not only because of the nature of the laws, but also because of other factors, such as the political environment in the country. Although 29 per cent of the respondents in question 1 attributed poor performance to outdated laws, 25 per cent felt that lack of a more democratic regime was more crucial. It is true to say that both of these factors have contributed to the mismanagement of companies. The significant majority of the respondents (36 per cent), who felt that gross mismanagement of companies has been the cause of poor performance, confirms this.

Responses to Question 2 clearly indicate that donations from companies' resources are beneficial. Forty-six per cent felt that donations promote useful purposes and 15 per cent considered them useful for the purposes of enhancing the image of the company. However, a significant number (39 per cent) felt that donations encourage corruption. The responses against donations could have been influenced by past abuse of political donations in Kenya. In the past, donations by directors of parastatals have been given to the government in return for political favours among other personal benefits. Such donations subsequently occasion heavy losses to shareholders and creditors.<sup>14</sup>

#### **Question 4: Company directors should assume social responsibilities in order to facilitate effective participation of employees in economic activities.**

This question was answered by 55 respondents. Fifty-seven per cent agreed with the statement, 10 per cent had no view, and 33 per cent disagreed.

Interviewee number 10 felt that imposing a responsibility on companies in Kenya to be socially responsible could have undesirable results due to the poor economy of

---

<sup>14</sup> The fact that many former directors of KCC (Kenya Co-operative Creameries-in receivership) have gone on to become Members of Parliament illustrates how good KCC has been as a spring board for

the country.<sup>15</sup> He contended that such an initiative is likely to succeed in more developed economies. Interviewee number 1<sup>16</sup> took the view that companies assume some social responsibilities, not because of the need to enhance their image, but to reduce their tax liabilities.

### **Commentary**

A majority of respondents (57 per cent) in Question 4 took the view that directors ought to consider social responsibilities so as to facilitate participation of employees in economic activities. This view confirms that a company cannot be regarded as just the association of shareholders because it also encompasses others who make commitments to it, namely employees, suppliers of goods and services, and customers. As such, a company would ultimately benefit by satisfying wider social objectives by ensuring productive relationships with a range of interested parties.<sup>17</sup>

### **Question 5: Company law principles relating to directors should be codified in the Companies Act to make the law more accessible.**

This question was answered by 55 respondents. Ninety-six per cent agreed, 2 per cent (consisting of one person) had no view, and 2 per cent (consisting, again, of one person) disagreed.

### **Commentary**

It is evident that a clear majority (96 per cent) of the respondents felt that codification is absolutely necessary. The need for such a change is supported by the fact that 76 per cent of respondents in Question 3 felt that directors breach their duties because the important company law principles are not codified in the Act and that the Act is difficult to understand.

---

political positions. See "Politics is killing the dairy industry", *Market Intelligence Business and Finance Journal*, June 21, 2000 < <http://www.mi.co.ke/archive/september/industry.html> >

<sup>15</sup> Interview conducted on 18 January, 2002 in Nairobi.

<sup>16</sup> Ibid, 7 January, 2002.

<sup>17</sup> A framework that is competitive and beneficial to the economy, the medium through which a company operates, should cater for both internal and external interests. See The Company Law Review Steering Group, *Modern Company Law for a Competitive Economy: The Strategic Framework*, February 1999, p 10.

**Question 6: Directors take their duties in relation to skill, care, and diligence seriously.**

This question was answered by 54 respondents. Forty-six per cent felt that directors took their duties seriously, 6 per cent had no view, and 48 per cent felt that they did not.

**Commentary**

Although more people felt that directors do not take their duties seriously, the 46 per cent that thought otherwise cannot be ignored. The number that felt that directors take their duties seriously can be attributed to the responses given by directors. Given that a majority of the respondents were directors (18), they might have been reluctant to admit lack of skill and care on their part or on the part of colleagues. In addition, it may well be that the directors quite genuinely felt that they do exhibit a degree of care and skill that can reasonably be expected from persons of their knowledge and experience. It is notable that this is the standard of care expected from directors in Kenya.<sup>18</sup>

**Question 7: There is no effective mechanism for shareholders to enforce liability of directors.**

Fifty-six individuals responded to this question. Eighty nine per cent agreed and 11 per cent disagreed. Although some of the comments made in Section C indicated that the Act has its shortcomings, they also noted that some of its useful provisions have not been utilised. The government (Registrar of Companies) was singled out as one of the bodies that is reluctant to enforce the provisions of the Act.

It was also mentioned that shareholders are disadvantaged because of difficulties in obtaining public documents from the Companies Registry. It was felt that lack of modern technology in the Registry was contributing to delays. Indeed, interviewee number 1 (an advocate specialising in corporate practice)<sup>19</sup> confirmed that the registry is so disorganised that company searches sometimes take at least three weeks to finalise.

---

<sup>18</sup> *Flagship Carriers Ltd v Imperial Bank Ltd*, High Court Civil Case No 1643 of 1999 (Unreported); J Ogolla, *Company Law*, (Nairobi: Focus Publications, 1997) p 176.

<sup>19</sup> Interview conducted on 7 January, 2002 in Nairobi.

Another reason for the lack of effective enforcement was considered to be that there are no supervisory agencies established to monitor the conduct of directors. The professional bodies that regulate their members, who are directors, were thought to be ineffective, as they do not strictly observe rules and regulations. A few of those mentioned were the Law Society of Kenya, the Kenya Institute of Management, and the Kenya National Chamber of Commerce & Industry.

Interviewee number 7 stated that "loss of faith in the judicial system affects the zeal of shareholders to sue."<sup>20</sup> He contended that the judicial system does not offer incentives to shareholders to sue directors. He also observed that directors are usually unlikely to endorse the commencement of proceedings against one of their own. Interviewee number 10 stated that "ignorance on the part of shareholders contributes to lack of enforcement."<sup>21</sup>

### Commentary

It is evident from Question 7 that a clear majority (89 per cent) agreed that there is no effective enforcement of the liability of directors. It is notable that the company is the only body that is entitled to sue a miscreant director in Kenya,<sup>22</sup> as his duties are only owed to the company.<sup>23</sup> As interviewee number 4<sup>24</sup> contended, it is possible for directors to escape liability when they form and control a majority of the shareholders because minority shareholders are precluded from pursuing enforcement suits unless the company has been a victim of a fraud or the conduct complained of is oppressive<sup>25</sup> to the interests of some shareholders.

The fact is, as noted by several respondents, that the inefficiency of the judiciary discourages shareholders from enforcing directors' liability more readily.<sup>26</sup>

---

<sup>20</sup> Ibid, 18 January, 2002.

<sup>21</sup> Ibid, 18 January, 2002.

<sup>22</sup> Proceedings may be instituted against a de facto or shadow director as well as a retired director, estate of a deceased director, and a bankrupt director. See *Curtis's Furnishing Stores Ltd v Freedman* [1966] 2 All ER 955. Proceedings may be instituted in the name of the company on the authority of the board of directors, a receiver manager or liquidator, or the General Meeting.

<sup>23</sup> *Foss v Harbottle* (1843) 2 Hare 461.

<sup>24</sup> Interviewee conducted on 18 January, 2002 in Nairobi.

<sup>25</sup> The Act, s 211.

<sup>26</sup> The subject of judicial reform is beyond the scope of this research. For more on judicial reform see Republic of Kenya, *The Report of the Committee on the Administration of Justice*, 1998, Chapter 9,



**Question 8: Inadequate management controls have affected parastatals' performance.**

This question was answered by all the 56 respondents. Ninety-four per cent agreed and of these 88 per cent strongly agreed with the statement.

**Question 9: Reforms initiated by the 1982 Working Party on Government and Expenditure and the Philip Ndegwa Committee on the Review of Statutory Boards 1979 have had little impact in improving the performance of parastatals.**

Fifty-five respondents answered this question. Eighty-five per cent felt that the reforms had little impact and 15 per cent had no view on the matter.

**Question 10: Privatisation would make directors' roles in parastatals more accountable.**

This question was answered by 56 respondents. Ninety-one per cent felt that it would make directors more accountable, one person had no view, and 7 per cent thought it would not.

Some comments made in Section C indicated that the problems of poor performance of directors can be traced back to the time when the Duncan Ndegwa Report of 1971<sup>27</sup> allowed directors and employees to engage in other businesses. As such, cases of conflicts of interest and neglect of duties are common.

Others took the view that privatisation would not enhance the performance of the privatised companies unless there is separation between ownership and management. One respondent felt that the management should be professional and not be appointed by shareholders. It was suggested that the performance of privatised companies would be enhanced by the reduction of the stake of the State in parastatals to less than 25 per cent. In addition, the enactment of privatisation legislation was thought necessary, as it would guide and control the process of

---

11 <<http://www.lawafrica.com/reports/go.asp?file=kwach.xml>> ; Amollo, "Judicial Reform", *The Advocate Magazine*, December 2000.

<sup>27</sup> Republic of Kenya, "Report of the Commission of Inquiry: Public Service and Remuneration Commission" (Duncan Ndegwa Report) 1971 in Courtney Nelson's *Development Strategies*,

privatisation which has been slow and partisan. It was felt that privatisation at the moment favours foreign investors and it can only benefit local investors if it is postponed until there is the accumulation of local capital and reorganisation of the co-operative societies. This, it was contended, would enable the co-operative societies to acquire ownership of privatised companies, and, in turn, enable local investors to have a stake in the companies.

Interviewee number 8 felt that the privatisation process should be strictly controlled to ensure that local investors have a majority stake in the running of strategic companies, such as the Kenya Power and Lighting Company and Kenya Railways.<sup>28</sup> However, interviewee number 1 stated that "privatisation is welcome provided that the privatised companies are run properly."<sup>29</sup>

### **Commentary**

It is evident from Question 8 that inadequate management controls have been responsible for the poor performance of parastatals. This was supported by 94 per cent of respondents. The overwhelming majority who agreed also nearly corresponds to those who thought that the divestiture of state interests in parastatals would enhance accountability (91 per cent felt that privatisation would improve accountability). Eighty five per cent in Question 9 also agreed with the statement that past attempts by the government to reform parastatals have been unsuccessful.

It is true to say that the control of parastatals by the government renders it difficult to enforce liability against directors, as the government protects them. It is possible that a majority of the respondents attributed lack of management controls in parastatals to the control exerted by the government.

However, it was interesting to note that 6 per cent of the respondents thought that there would be no change, unless the stake of the government's share is reduced significantly to less than 25 per cent and the privatisation process streamlined. This

---

"Administration and Economic Planning in Eastern Africa: A Ford Foundation Program Evaluation", 1977 <<http://www.developmentstrategies.org/Archives/1977ReviewEastAfrica/rea6.htm>>

<sup>28</sup> Interview conducted on 22 January, 2002 in Nairobi.

<sup>29</sup> Ibid, 7 January, 2002.

is because some respondents confirmed that the process was slow and partisan. This clearly shows the apprehension that exists in relation to management by the State.

As mentioned by some respondents, the poor performance of parastatals can also partly be attributed to directors' competition with their institutions. A total of 24 per cent in Question 3 attributed breach of duties to competition by directors with their companies. As comments in Section C show, this problem can be traced back to the early 1970s when the Duncan Ndegwa Report of 1971 was issued. The report made recommendations which permitted civil servants to own and participate in private businesses as an incentive for them to remain in the civil service.<sup>30</sup> Although the measure might have enabled the government to retain civil servants, it also made it possible for directors and other workers to put themselves in positions where their personal interests conflicted with those of companies. For instance, it is possible for a director to hold multiple directorships<sup>31</sup> on various boards. Although the service of some directors might be useful to companies where they serve as a source of non-executive talent,<sup>32</sup> clearly serving in multiple roles makes it difficult for directors to avoid breaching their duties.

**Question 11: Directors of multinational corporations operating in Kenya do not have regard to responsibilities which they have in other countries.**

The question was answered by 54 respondents. Forty-five per cent took the view that multinationals do not have regard to such responsibilities, 22 per cent had no view on the matter, and 33 per cent felt that they did.

---

<sup>30</sup> Republic of Kenya, op cit n 27.

<sup>31</sup> Multiple directorships are recognised by both the Companies Act and Table A. Section 201 requires particulars of all directorships to be contained in the register of directors and secretaries. Table A, article 78 allows a director to "become a director or other officer of, or otherwise interested in, any company promoted by the company or in which the company may be interested as shareholder or otherwise, and no such director shall be accountable to the company for any remuneration or other benefits received by him as a director or officer of, or from his interest in, such other company unless the company otherwise directs."

<sup>32</sup> Both the Greenbury's Report (Directors Remuneration: Report of a Study Group chaired by Sir Richard Greenbury, July 4, 1995) and Cadbury Committee (Report of the Committee on the Financial Aspects of Corporate Governance, 1992) underscore the supervisory role of the non-executive directors. They are also a good source for non-executive talent for other companies.

Interviewee number 4<sup>33</sup> highlighted the need to regulate multinationals effectively, as most are prone to abusing their positions due to their immense wealth and ability to influence. He also felt that a vast majority of them do not invest adequately in Kenya. Interviewee number 1<sup>34</sup> asserted that the government is attempting to control multinationals to some extent. As an indication of this she cited a case where the government refused to approve an attempt by Coca-Cola to take over all soft drinks subsidiaries in the country.

### **Commentary**

A majority of respondents (45 per cent) felt that multinational corporations in Kenya do not accept responsibilities that they have in other countries.<sup>35</sup> The interviewee who felt that there is a need to regulate multinationals more strictly, as there exists an inequality of bargaining power between them and the State, also supported this view. It is true that multinational corporations<sup>36</sup> rarely take measures to invest locally or to stop the abuse of their considerable economic and social power.<sup>37</sup> They do this because the government may discourage the creation of stricter legislative and enforcement frameworks on the basis that they would risk being construed as hostile towards strong foreign investors.

### **Question 12: In light of Kenyan circumstances, self-regulation by directors would be more effective than statutory control.**

This question was answered by 55 respondents. Sixty-nine per cent took the view that self-regulation would not be effective, one person had no view on the matter, and 29 per cent thought it would.

---

<sup>33</sup> Interviewed on 18 January, 2002 in Nairobi.

<sup>34</sup> Ibid, 7 January, 2002.

<sup>35</sup> "Multinational companies and privatised utilities are not vehicles for the business venture of their shareholders. They are entities with their own aspirations, goals, and histories. The largest of them have annual turnovers greater than the GNP of most sovereign states." See Bamford, "Directors' Duties: The Public Dimension" (2000) 2 Co Law 38 at 38.

<sup>36</sup> Muchlinski, "The Accountability of Multinational Enterprises and the Right to Development: The Compensation of Industrial Accident Victims from Developing Countries," [1993] *Third World Legal Studies*, 189 at 192.

<sup>37</sup> A Drzemczewski, *European Human Rights Convention in Domestic Law* (Oxford University Press, 1983) Ch 8. Cited in Muchlinski, *ibid*, at 191.

## Commentary

It is clear from the views obtained that a majority of the respondents (69 per cent) were against<sup>38</sup> self-regulatory codes. <sup>39</sup> The disadvantages of a self-regulatory scheme might have prompted the majority to feel that a self-regulatory code would not be successful, unless underlying problems, such as corruption, are solved.

### **Question 13: A non-statutory statement of directors' duties would offer useful guidelines to directors.**

Fifty-five respondents answered this question. Sixty-two per cent felt that the non-statutory statement would be useful, 6 per cent had no view, and 32 per cent felt that it would not.

Comments made in Section C in relation to awareness indicated that directors are more likely to comply with regulations if they understood their obligations.<sup>40</sup> A director of several parastatals admitted that he has never read the recommendations made by two committees<sup>41</sup> established to streamline the operations of parastatals. He also claimed that he has never been told what is expected of him as a director.

It was also felt that the awareness of shareholders should be encouraged to ascertain when they ought to enforce liability against miscreant directors. To raise levels of awareness, it was felt that simplified company books and pamphlets should be published. It was also deemed necessary for directors of public corporations to

---

<sup>38</sup> The Kenyan Parliament recently disagreed with the wishes of the Treasury, the World Bank and the IMF by passing a bill limiting the interest rates of banks. See "Welcome to Kenya, IMF's Little Colony", *Daily Nation*, 20 May, 2001.

<sup>39</sup> At a seminar organised by Kenya Institute of Policy Planning, Research and Analysis on 16 May 2001, Mr Jimnah Mbaru, criticised the implementation of the International Accounting Standards (IAS) on the basis that they were only favourable towards foreign owned multinational banks as Kenya's banks were constrained by the short term nature of Kenyan deposits. Another reason advanced against the IAS was that the Kenyan judicial system discourages the quick dispensation of commercial cases. See "Banker, NSE Chief Riled by IAS", *East African Standard*, 17 May, 2001.

<sup>40</sup> The UK's Hampel Final Report on Corporate Governance (Gee, London, 1998). recommended that directors should have guidelines to help them understand their duties. The report culminated in the publication of 'The Combined Code' of best practice. The code was published by the London Stock Exchange on 25 June 1998 as part of the listing rules. However the code has no force of law. The code incorporated the recommendations made by the Cadbury Committee Report (Report of the Committee on the Financial Aspects of Corporate Governance (London: Gee, 1992) and the Greenbury Committee Report 1995 (Directors' Remuneration: Report of a Study Group Chaired by Richard Greenbury, 1995).

<sup>41</sup> The Philip Ndegwa Committee on the Review of Parastatal Boards 1979 and the 1982 Working Party on Government and Expenditure.

undertake a certified course,<sup>42</sup> and to use simple language in the memorandum and articles of association in order for them to be easily understood. The need to have minimum qualification requirements for appointment of directors in public companies was identified by several interviewees.

### **Commentary**

It is notable that the Private Sector Corporate Governance Trust (PSCGT) has begun promoting corporate governance awareness among the Kenyan public. The Trust was founded in March 1999 to promote good corporate governance.<sup>43</sup> This initiative is commendable because it is likely to enhance the competence of directors and the activism of shareholders.<sup>44</sup>

#### **Question 14: Adoption of international standards of corporate governance would establish standards of good practice in management of companies.**

Fifty-four respondents answered this question. Ninety two per cent agreed, one person had no view, and 3 people disagreed with the statement.

#### **Question 15: Foreign companies avoid doing business in the Kenyan market due to the weak corporate regulatory framework.**

This question was answered by 54 respondents. Fifty-four per cent agreed, 6 per cent had no view, and 40 per cent disagreed with the statement.

### **Commentary**

According to the data obtained in Question 15, it would seem that the corporate regulatory framework in Kenya is a disincentive to foreign investment. Although this is the case, the respondents (40 per cent) who felt that it was not a disincentive could have attributed the avoidance of the Kenyan market to other factors, such as

---

<sup>42</sup> The UK's Cadbury Report (Report of the Committee on the Financial Aspects of Corporate Governance (London: Gee, 1992) para 4.19 also suggested that directors should take internal or external training. It is notable that since 1983 the UK's Institute of Directors (IOD) has been offering a Company Direction Programme leading to an IOD Diploma in Company Direction. It also introduced a new professional qualification in June 1999 called the certificate of Chartered Director (C Dir). See B Pettet, *Company Law*, (Pearson, 2001), 224.

<sup>43</sup> <[www.corporategovernance.co.ke](http://www.corporategovernance.co.ke)>

<sup>44</sup> United Kingdom's Department of Trade and Industry has leaflets that are designed to promote awareness. See <<http://www.dti.gov.uk>>

corruption. Interviewee number three<sup>45</sup> felt that political patronage and corruption have adversely affected the competitiveness of Kenya's regulatory framework. Similar sentiments were identified in the responses given in Section C. It is true to say that mismanagement of companies can be linked to the numerous opportunities tempting directors to engage in corruption.

**Question 16: There is little chance of directors being sued for breach of duties when companies enter liquidation.**

Fifty-four respondents answered this question. Eighty-nine per cent felt that there is little chance for such an action, 4 per cent had no view, and 7 per cent felt that such actions are frequent.

**Question 17: Directors' disqualification orders are extremely rare.**

This question was answered by 55 respondents. Ninety-two per cent agreed, 4 per cent (consisting of 2 people) had no view, and 6 per cent moderately disagreed with the statement.

**Question 18: An effective disqualification regime of directors would promote standards of corporate governance.**

Fifty-four respondents answered this question. Ninety-eight per cent agreed with the statement and 1 person (making up 2%) had no view on the matter.

Comments made in Section C in relation to disqualification indicated that the penalties in the Act are ridiculously low. Interviewee number 4<sup>46</sup> also felt that imposing penal sanctions on errant directors would deter misconduct. He particularly emphasised that individuals have been careful not to breach corruption laws with criminal penalties.

**Commentary**

The data reveals that disqualification orders are very rare and that a stricter disqualification regime would ensure that unfit directors do not serve on boards. The responses could be a reflection of the many companies that are still run by

---

<sup>45</sup> Interviewee conducted on 11 January, 2002.

<sup>46</sup> Ibid, 18 January, 2002.

incompetent, negligent, and fraudulent directors due to lack of a proper<sup>47</sup> disqualification regime.<sup>48</sup>

### 9.3 Conclusions

This empirical research has shown that the regulatory framework for directors has serious flaws which need to be addressed urgently in order to minimise the adverse effects caused by mismanagement of companies. The data appears to be consistent with the views taken in numerous newspaper articles in the past ten years that the regulatory system is extremely ineffective and is detrimental to the Kenyan economy.

The data reveals that companies perform poorly not only because of the nature of the laws, but also because of other factors, such as a weak economy, the political regime, corruption, and mismanagement. These factors, for instance, affect the effectiveness of the judiciary and, in turn, contribute to loss of confidence in the judicial system by citizens. As such, *directors are able to escape liability easily* because shareholders are unlikely to trust the courts to enforce effectively the provisions of the Act.

Company law in Kenya remains largely inaccessible due to lack of codification. The present status makes it difficult for directors and shareholders to ascertain their obligations. This, therefore, prevents directors from taking their duties in relation to skill and care seriously. Since the level of directors' awareness is low, a non-statutory statement of directors' duties would offer useful guidelines to directors, as they are more likely to comply with regulations if they understood their obligations. Publication of simplified company books and pamphlets may also go along way towards promoting awareness.

---

<sup>47</sup> "The tragedy in Kenya is that those who have mismanaged the Government, the Development Finance Institutions, and even multinational corporations are those who continue to circulate in and out of Government as ministers, assistant ministers, advisers and so on." See Nyong'o, "How Bad Governance Strangles Business", *Daily Nation*, 10 June, 2001.

<sup>48</sup> Some 45 parastatals and companies in which the Government has shares have been placed in receivership since 1980. Some of the directors who are responsible for the collapse of such companies have not only been appointed to other positions of directorships but they have also been appointed to the Cabinet. For example, despite the allegations levelled against the former managing directors of the defunct Kenya National Assurance and Kenya Posts and Telecommunications Corporations, Henry Kosgey and Kipng'eno arap Ng'eny respectively, the two were appointed to



Although some respondents felt that imposing a responsibility on companies in Kenya to be socially responsible could have undesirable results due to the poor economy of the country, it was evident from the data that such an initiative is useful, as failure to have regard to social roles may affect the productivity of companies. The data has also shown that although donations can help certain good causes, they are often open to abuse.

The data reveals that self-regulation would not be as effective as statutory regulation in Kenya. This is because there are some underlying problems, such as corruption, which need to be minimised for self-regulation to be effective.

It has been shown that inadequate management controls have been responsible for the poor performance of parastatals. Also, past attempts by the government to reform parastatals have been unsuccessful. *In fact, past reforms have enabled* directors and employees to be involved in competing businesses with parastatals hence encouraging neglect of duties and conflicts of interest. Given that the stake of the Government in parastatals enables it to exercise control over their boards of directors, divestiture of the interests of the State in parastatals remains one of the options that may well enhance their performance.

Although the corporate regulatory framework is clearly a disincentive for foreign investment, multinational corporations operating in Kenya do take advantage of the ineffective regulatory framework for directors. Thus, they rarely have regard to responsibilities that they have in other countries. Indeed, most are prone to abusing their power because of their immense wealth and the inequality of bargaining power between them and the State.

It is evident that directors are rarely sued for breach of duties when companies enter liquidation, and they are also rarely disqualified. An effective disqualification regime would therefore promote standards of corporate governance. The responses are reflective of the dire need there is to make the disqualification regime stricter.

---

direct other companies and subsequently appointed to the Cabinet. See "45 Parastatals, Govt Firms in Receivership" *East African Standard*, 12 July, 2001.

Overall the empirical data demonstrates that there is an urgent need to effect reforms in the law and the environment within which companies operate so as to raise the standards of corporate governance, and in turn, promote the competitiveness of the regulatory framework for directors.

## CHAPTER TEN

### 10. 0 RECOMMENDATIONS FOR REFORM

#### 10.1 Introduction

The foregoing chapters have illustrated how the current regulatory framework for directors is inadequate and unsatisfactory in order to protect the interests of shareholders, creditors, and other stakeholders of the company. It is evident that both the regulatory framework for directors and the political environment within which companies operate impinge upon the performance of companies. According to the empirical data that is analysed in Chapter 9, fifty-four percent of the respondents felt that foreign companies avoid doing business in the Kenyan market due to the weak corporate regulatory framework, while forty percent felt other factors, such as a weak economy and corruption, contributed more .

A legal system can hardly be effective if it does not set legal standards, implement and enforce these standards, resolve disputes, and limit the power of the state.<sup>1</sup> For instance, it is undoubtedly the case that institutional reforms of the judiciary and the civil service would reduce corruption and, in turn, enhance the efficiency of the corporate regulatory framework. It is thus important to reform the environment within which companies operate as well as the Companies Act ("the Act"). Although it can be argued that properly designed laws would not be of any use if there is no mechanism in place to implement and enforce them, it is necessary to begin the process of developing an efficient legal system by preparing "a set of written laws that clearly delineate individual's rights and responsibilities and that embody market friendly economic policies."<sup>2</sup> This chapter makes recommendations for reform which, it is submitted, if adopted, would make the regulatory framework for directors modern, effective, transparent, straight-forward, and easier to understand.

---

<sup>1</sup> Gray, "Reforming Legal Systems in Developing and Transition Countries", September 1997, 34, *Finance and Development* < <http://www.worldbank.org/fandd/english/abstract/0997/014a0997.htm>>.

<sup>2</sup> Ibid.

## 10.2 Codification

As mentioned in Chapter 1, the common law principles applicable in Kenya are not codified in the Act.<sup>3</sup> As such, the Kenyan courts apply English common law principles and have hardly adopted a Kenyan approach to the interpretation of the Act.<sup>4</sup> The duties of directors are also regulated by fiduciary duties, statutory duties, and the Nairobi Stock Exchange Listing Rules. These rules, especially the case law, do not clearly set out the law for directors and the stakeholders of the company. It is evident from the empirical data that a clear majority (96 per cent) of the respondents felt that codification is absolutely necessary. This is supported by 76 per cent of respondents in Question 3 who felt that directors breach their duties because important company law principles are not codified in the Act. Potently, the failure to have the law codified renders adherence to the law problematic and it renders it impracticable for various interest groups to have easy grasp of the duties and responsibilities of directors.<sup>5</sup>

It was demonstrated in the early chapters of this study that the common law rules on the regulation of directors is unclear. Because of this, the rules should be clarified in a legislative framework so that they can provide clear guidance to directors and the stakeholders on the responsibilities of directors. The clarification of rules would not only provide an opportunity to correct defects in the present law,<sup>6</sup> but also raise standards of corporate governance by making the law accessible and its enforcement perhaps more achievable.

Although codification would make the law accessible, it is notable that some commentators have argued against it on the basis that the courts would still face the

---

<sup>3</sup> Chapter 486, Laws of Kenya.

<sup>4</sup> In *Flagship Carriers Ltd v Imperial Bank Ltd*, High Court Civil Case No 1643 of 1999 (Unreported), Mr PJS Hewett indicated that a subjective test, as laid down by Romer J in *Re City Equitable Fire Insurance Co* (1925) Ch 407, should be applied to assess the standards of directors' duties of skill and care. The application of both the subjective and the objective standards has been favoured in other jurisdictions, as it raises the standards expected from directors. See *Re D'Jan of London Ltd* [1993] BCC 646 (UK), *Norman v Theodore Goddard* [1992] BCC 14 at 15 (UK), and *Daniels v Anderson* (1995) 37 NSWLR 438 (Australia).

<sup>5</sup> In the UK, it has been proposed that a statutory statement should be formulated to make the doctrine useful as a guide to directors. See DTI, The Company Law Review Steering Group: Final Report: Final Report, 2001, p 41; Company Directors: Regulating Conflicts of Interest and Formulating a Statement of Duties (Law Commission Consultation Paper No. 153, London: Stationery Office, 1998), Part 15.

difficulty of balancing between entrepreneurial risk taking and reasonable prudence. As such, they have argued that the courts should "not be trusted without firm statutory guidance to appreciate the realities which beset a modern company director, and are likely to be too restrictive and inhibiting."<sup>7</sup> Full codification of the duties of directors has also been criticised on the basis that it would not augur well for directorial responsibility due to the constant changing nature of legal regulations on responsibility.<sup>8</sup> The adoption of the language of the cases may also make the codes inaccessible, unless the wording of clauses avoids ambiguity.<sup>9</sup>

Whilst some of the arguments against codification may be sound, a clear wording of the clauses would avoid the ambiguity<sup>10</sup> and, in turn, offer useful guidelines to the courts. It is submitted that codification of the common law principles is necessary because it would not only be useful to the courts but also make it easier for directors to understand their responsibilities and enable stakeholders to appreciate what they should expect from directors, something that has been difficult because of the inaccessibility of the common law.

### 10.3 Awareness

The performance of companies can be enhanced by ensuring directors have certain essential knowledge, such as knowledge of: relevant law; their duties, responsibilities, and liabilities; financial analysis; strategy; business ethics and effective decision making. Thus, it is important for directors who do not have the

---

<sup>6</sup> Sheikh, "Company Law for the 21<sup>st</sup> Century: Part 2: Corporate Governance", [2002] 13 (2) ICCLR 88, at 88.

<sup>7</sup> Santow, "The Codification of Directors' Duties: Some Observations from an Australian Standpoint on the Joint Consultation Paper of September 1998 issued by the Law Commission of the United Kingdom" (2000) 2 ICCLR 127, at 144.

<sup>8</sup> A similar recommendation was favoured by UK Law Commission, *Company Directors: Regulating Conflicts of Interests and Formulating a Statement of Duties*, Cmnd 4436, HMSO, London, 1999, paras 4.48, 5.19-5.20, and 5.38. The Commission observed "we expect that the law will need to continue to evolve incrementally as circumstances require. The commercial context is consistently changing. It is important that the law retains the capacity to develop. For this reason we think that a full codification of directors' duties would not be desirable. To set out in statute duties that are still developing might restrict their ability to adapt to changing circumstances." See paras 4.27-4.28.

<sup>9</sup> Birds, "Making Directors do their Duties" [1980] Co Law 67, at 67. The learned commentator observes that the past attempt to codify secret profit rules (Clause 52 (2) Companies Bill 1973; Clause 44 (3)-(6) Companies Bill 1978, refers to conflict of duty and interest without considering the real understanding of the cases to determine the sort of factual situations covered.

<sup>10</sup> In the past clauses in the UK Companies legislation have adopted the language of cases establishing fiduciary obligations. Professor Birds observes that the past attempt to codify secret profit rules (Clause 52 (2) Companies Bill 1973; Clause 44 (3)-(6) Companies Bill 1978, refers to

requisite knowledge to undergo some training so that they can perform more effectively. The empirical data has shown that 62 per cent of the respondents felt that a non-statutory statement of directors' duties would offer useful guidelines to directors. It is submitted that the measures initiated by the Private Sector Corporate Governance Trust (PSCGT)<sup>11</sup> to promote corporate governance awareness among the Kenyan public are useful because they are likely to enhance the competence of directors and the activism of shareholders.<sup>12</sup> Awareness can be enhanced further by having more organisations with similar objectives and the publishing of simplified company books and pamphlets. Directors of public corporations should be required to undertake a certified course in order to enhance their competence. This is consistent with recommendations made by the UK's Cadbury Report.<sup>13</sup> The report suggested that directors should take internal or external training. It is notable that since 1983 the UK's Institute of Directors (IOD) has been offering a Company Direction Programme leading to an IOD Diploma in Company Direction. It also introduced a new professional qualification in June 1999 called the certificate of Chartered Director (C Dir).<sup>14</sup>

#### **10.4 Directors' Role in Social Responsibility**

The directors of a company owe duties of good faith to the company.<sup>15</sup> According to economic contractarian theories, companies should not be concerned with the interests of employees and other stakeholders because their prime purpose is to maximise the wealth of shareholders.<sup>16</sup> This obligation does not give directors room to take into consideration<sup>17</sup> the interests of employees or other stakeholders.<sup>18</sup> This

---

conflict of duty and interest without considering the real understanding of the cases to determine the sort of factual situations covered. See Birds, *ibid*, at 67.

<sup>11</sup> The trust was founded in March 1999 to promote good corporate governance. See <[www.corporategovernance.co.ke](http://www.corporategovernance.co.ke)>

<sup>12</sup> United Kingdom's Department of Trade and Industry has leaflets that are designed to promote awareness. See <<http://www.dti.gov.uk>>

<sup>13</sup> Report of the Committee on the Financial Aspects of Corporate Governance (London: Gee, 1992) para 4.19.

<sup>14</sup> B Pettet, *Company Law*, (Pearson, 2001), 224.

<sup>15</sup> *Percival v Wright* [1902] 2 Ch 421. Directors may, however, stand in a fiduciary relationship to the members if members authorise them to negotiate on their behalf. See *Briess v Wolley* [1954] AC 333

<sup>16</sup> Jensen and Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure", (1976) 3 *Journal of Financial Economics* 305.

<sup>17</sup> It is notable that some companies encourage employees to purchase shares, offer gratuities, and medical attention. See P Thomas, *Private Enterprise and the East African Company*, (Tanzania Publishing House Ltd, 1969) p 29.

position focuses on the narrow interests of members rather than the long-term interest of the enterprise. The current regulatory framework is a barrier to profit sacrificing behaviour because it fails to appreciate that it is for the general benefit of the corporate entity to “consider itself as a citizen with a role to perform in a social as well as in an economic context.”<sup>19</sup> This has adverse effects on Kenya's societal interests. For instance, employees are vulnerable because there is no statutory protection which permits directors to offer compensation by making *ex gratia* provision for employees.<sup>20</sup> Moreover, directors are not under any obligation to establish pension schemes for employees or to safeguard the long-term interests of employees by running their company efficiently.

According to the concession and communitarian theories, the company is an entity having both a public role and a private one.<sup>21</sup> It is therefore necessary for a company to recognise the interests of employees and creditors because they contribute immensely to the success of the company.

Whilst it has been argued that the ultimate objectives of companies are to generate maximum value for shareholders,<sup>22</sup> there can be no doubt that maximising shareholder value does not achieve maximum prosperity and welfare for the society in which the company operates.<sup>23</sup> An appropriate corporate governance system

---

<sup>18</sup> For social responsibilities, such as donations, to be lawful they must be authorised by the company's memorandum or reasonably incidental or conducive to carrying on the business of the company (*Tomkinson v South-Eastern Railway Co* (1887) 35 Ch D 675). In Germany the duty of directors is broadly expressed to include employees and the public interest. Section 309 of the UK 1989 Companies Act obliges directors of a company to have regard to the interests of the company employees. In practice, however, enforcement of this duty is rendered inconsequential by the ultimate control of shareholders and the fact that the duty is owed to the company rather than employees. It is therefore difficult for employers to enforce it unless shareholders are in favour of such enforcement. Although employees do not have a remedy under the section, the section might be able to confer immunity to directors, who can rely on it to claim that their neglect of duty was due to employees' considerations. See *Fulham Football Club v Cabra Estates* [1994] 1 BCLC 363 (CA) in Company Law Review Steering Group, *Modern Company Law for a Competitive Economy: The Strategic Framework*, February 1999, p 31.

<sup>19</sup> P Thomas, *op cit* n 17, p 14.

<sup>20</sup> This is allowed in the UK. See section 719 of the Companies Act 1985 and section 187 of the Insolvency Act 1986.

<sup>21</sup> M Stokes, “Company Law and Legal Theory” in *Legal Theory and Common Law* (W Twining, ed, 1986) pp 155, 162.

<sup>22</sup> This is the enlightened shareholder approach. See M Blair, *Ownership and Control: Rethinking Corporate Governance for the twenty-first Century* (1995) in The Company Law Review Steering Group, *op cit* n 18, p 31; J Parkinson, *Corporate Power and Responsibility*, (Clarendon Press, 1993) p 260.

<sup>23</sup> This is the pluralist approach. See Blair M, *Ibid*.

demands harmony between different stakeholders whose common objective is the success of the corporation.<sup>24</sup> For instance, having regard to social responsibilities might improve the reputation of a company with customers and potential employees and, in turn, boost sales and the productivity of employees.<sup>25</sup> It is possible that the creation of a stable social environment in which the company operates would also profit the company by bringing in new business. In the UK, for instance, Marks and Spencer's community expenditure has been justified on the basis that urban disorders would reduce the purchasing power of its customers and, in turn, entail an end to its 260 stores.<sup>26</sup> In fact, the empirical data in Chapter 9 has clearly shown that directors ought to consider social responsibilities so as to facilitate participation of employees in economic activities (57 percent of the respondents felt so).

Although it might be the case that requiring directors to have regard to the interests of employees would not be suitable for a developing economy which is keen to attract investments,<sup>27</sup> it remains true to say that the failure to take the interests of employees into consideration adversely affects the productivity of employees and, in turn, the performance of the company. Given that companies and the society as a whole stand to benefit from consideration of community interests by directors, it is important to require directors to have regard for social responsibilities. It is thus submitted that the duties of directors ought to focus on the long term interests of the enterprise rather than the narrow interests of members.<sup>28</sup> Directors ought to weigh the interests of stakeholders while making decisions because companies can enhance their long-term productivity by sacrificing profits in the short term.<sup>29</sup>

---

<sup>24</sup> S Sheikh and W Rees, *Corporate Governance and Corporate Control*, (Cavendish Publishing Limited, 1995).

<sup>25</sup> J Parkinson, *op cit* n 22, p 261.

<sup>26</sup> *Ibid*, p 294.

<sup>27</sup> This position was favoured in Nigeria. See Nigeria Law Reform Commission, *Working Papers on the Reform of Nigerian Company Law: Volume 1-Review and Recommendations*, 1987 pp 203-204.

<sup>28</sup> Schedule 2, of the draft Companies Bill prepared by the UK's Company Law Steering Group requires directors to foster good relationships with employees, suppliers, customers, environment, and members. See para 2 in Sheikh, *op cit* n 6, at 88.

<sup>29</sup> C Villiers, *European Company Law: Towards Democracy* (Ashgate Publishers, 1998) p 203. Cited in Paton, "Codification of Corporate Law in the United Kingdom and European Union: The Need for the Australian Approach", [2000] 11 (9) ICCLR 309, 316.



Given that it would be impossible to enforce a provision requiring directors to have regard to the interests of employees,<sup>30</sup> as directorial duties are owed to a company rather than employees, it would be preferable to give employees full voting rights within a company by allowing employees to nominate representative directors. Such representative directors would be able to protect the interests of employees by voicing their concerns at the board level. In the event that representative directors are outvoted and directors continue with misconduct, the representatives would be able to challenge managerial conduct as minority shareholders,<sup>31</sup> where the employees own shares.<sup>32</sup> Further protection might be given to employees by enabling employees to call for the investigation of the company by the Registrar of Companies where misconduct of directors affects the interests of employees.<sup>33</sup> It is notable that the Act is prohibitive, as it only allows a member to call for the investigation of a company.<sup>34</sup> It is submitted that employees ought to be given this right without being required to provide security for costs, something that would be a barrier to employee action.

#### 10.4.1 *Multinational Corporations*

According to an empirical study conducted by Bornschier and Stamm,<sup>35</sup> entry of multinational corporations in a market contributes to short term economic growth, but reduces long term growth performance. Since multinational corporations are foreign owned, their ultimate objective is to maximise profits for their Western owners and not to improve the welfare of the host countries.<sup>36</sup>

---

<sup>30</sup> Professor David Milman has suggested that section 309 of the UK's Companies Act 1985, which requires directors to have regard to the interests of employees, can be made more effective by enabling a recognised trade union to invoke it. See D Milman, "From Servant to Stakeholder: Protecting the Employee Interest in Company Law", in D Feldman and F Meisel (ed), *Corporate and Commercial Law: Modern Developments*, (Lloyds of London Press, 1996) p 170.

<sup>31</sup> In the UK courts have said that employee shareholders cannot enforce the expectations of employees, unless the concerned entity was a small private company in which the employee was a key figure in its operations. As such, section 459 of the Companies Act 1985 has not been applicable in all circumstances. See *Re A Company No 00477 of 1986* [1986] BCLC 376 and *Re Unisoft Group Ltd. (No 3)* [1994] 1 BCLC 609; D Milman, *ibid*, p 170.

<sup>32</sup> Section 56 (3) of the Act permit companies to loans to employees to acquire shares in the company.

<sup>33</sup> Professor David Milman has suggested that employees should have "an express right to call for the investigation of their company by the DTI." See D Milman, *op cit* n 30, p 170.

<sup>34</sup> Section 165 (1).

<sup>35</sup> V Bornschier and H Stam, "Transnational Corporations" in *The Law of the Business Enterprise* (S Wheeler, ed, OUP 1994), pp 333-334.

Although directors of multinationals are required to have regard, in some countries, for the interests of stakeholders, such as employees,<sup>37</sup> they are not required to take similar interests into consideration in Kenya. The empirical data confirms that multinational corporations in Kenya do not accept the same responsibilities that they have in other countries.<sup>38</sup> (Forty-five per cent took the view that multinationals do not have regard to such responsibilities, 22 per cent had no view on the matter, and 33 per cent felt that they did). It is notable that whilst multinational corporations have legally binding rights vis-à-vis the state and citizens, they do not have corresponding responsibilities for labour standards, human rights, or environmental protection.<sup>39</sup> Although multinational corporations make positive contributions to Kenya's economy, the failure to require them to have regard to the interests of employees and other stakeholders is both biased and discriminatory,<sup>40</sup> as it exonerates them from standards that they have to meet in other countries.<sup>41</sup>

The failure of multinationals to invest locally or refrain from abusing their considerable economic and social power,<sup>42</sup> is attributable to unfair international trade rules, the reluctance of the government to create a strict legislative framework lest it is construed as hostile towards strong foreign investors, and their influence on political life which often results in corruption of the democratic process.<sup>43</sup> Commenting on the need for business to have political protection, the general

---

<sup>36</sup> Office of Technology Assessment, U.S. Congress, *Multinationals and the National Interest: Playing by Different Rules* (US Government Printing Office, Washington DC, 1993), pp 1-4. Cited in J Dine, *Company Law*, (Sweet & Maxwell, 2001) p 6.

<sup>37</sup> Section 309 of the UK's 1989 Companies Act.

<sup>38</sup> "Multinational companies and privatised utilities are not vehicles for the business venture of their shareholders. They are entities with their own aspirations, goals, and histories. The largest of them have annual turnovers greater than the GNP of most sovereign states." See Bamford, "Directors' Duties: The Public Dimension" (2000) 2 Co Law 38 at 38.

<sup>39</sup> Kirkpatrick et al, "The OECD Multilateral Agreement on Investment", [1998] 4 *International Trade Law and Regulation*, 125.

<sup>40</sup> Article 26 of ICCPR states that all persons are entitled without any discrimination to the equal protection of the law and that "the law shall ... guarantee to all persons equal and effective protection against discrimination on any ground such as race, colour, sex, language, religion, political or other opinion, national or social origin, property, birth or other status."

<sup>41</sup> Section 309 of the UK's 1989 Companies Act requires directors to have regard to the interests of employees. However, this section is of little practical value because employees are unable to enforce it due to the fact that the duties of employees are owed to the company.

<sup>42</sup> A Drzemczewski, *European Human Rights Convention in Domestic Law* (Oxford University Press, 1983) Chapter 8. Cited in Muchlinski, "The Accountability of Multinational Enterprises and the Right to Development: The Compensation of Industrial Accident Victims from Developing Countries," [1993] *Third World Legal Studies*, 189 at 191.

<sup>43</sup> Karliner, *The Corporate Planet*, tracing the "capture" of the U.S. Government. Cited in Janet Dine, *op cit* n 36, p 6.

manager of Shell Nigeria stated in 1995 that “for a commercial company trying to make investments, you need a stable environment.... Dictatorship can give you that.”<sup>44</sup>

Although the General Agreement on Tariffs and Trade (GATT) and the World Trade Organisation (WTO) have created rules to govern cross-border trade in goods and services, they have not established comprehensive rules on investment which would act as a safeguard against abuse of power by multinational corporations.<sup>45</sup> In fact, most multilateral rules on trade are protective of foreign investors rather than the host country. For instance, Article III of GATT 1994 requires a host country to provide a foreign investor treatment no less favourable than that accorded to domestic investment or investors. Similarly, the WTO Agreement on Trade-Related Investment Measures (TRIMs Agreement) *prohibits the imposition* of certain performance requirements on foreign investment by host countries.<sup>46</sup> The initiatives of the Organisation for Economic Co-operation and Development (OECD) have also been more skewed towards the protection of foreign investors rather than the host countries. For instance, apart from excluding developing countries from the OECD negotiations which led to the drafting of Multilateral Agreement on Investment, the draft rules made no provisions for the obligations of investors. Instead, the rules prohibited various performance requirements which can be used by host countries to promote local business. These include: technology transfer requirements, hiring of local personnel requirements, and nationality requirements for executives and members of the boards of directors. The only existing safeguards against abuse of power are the OECD non-binding guidelines for multinational enterprises. The rules cover, inter alia, employment and industrial relations, environmental protection, technology transfer, and the disclosure of information. However, the guidelines are of little practical value because they are not enforceable.<sup>47</sup>

---

<sup>44</sup> Ibid.

<sup>45</sup> Schlegelmilch, "WTO: Why Still No Multilateral Rules for Foreign Direct Investment", [2000] 6 (3) *International Trade Law and Regulation*, 78, 78.

<sup>46</sup> Ibid.

<sup>47</sup> Kirkpatrick et al, op cit n 39, at 125; Schlegelmilch, "International Rules on Foreign Direct Investment: A New Challenge for the World Trade Organisation", *International Trade Law and Regulation*, [1996] 2 (6), 212, at 214.

Due to the immense wealth of multinational corporations, their ability to out negotiate the Government in various transactions, the support given to them by their home governments, and the international trade regulatory framework, it is unlikely that the Kenyan Government would be able to enter into bilateral treaties which are as favourable as those existing between developed countries.<sup>48</sup> It is submitted that fair multilateral rules on investments should be adopted in order to provide a level playing field by protecting the host country as well as foreign investment. These rules should be enforced by an effective and unbiased international institution.

#### **10.4.2 Donations**

Although the consideration of social responsibilities has positive effects, it is important to regulate some undertakings, such as the giving of donations, because they are prone to abuse. This was confirmed by the 39 percent of respondents in Question 2 of the questionnaire who felt that donations encourage corruption. Although it may well be argued that donations by companies to political parties have social benefits in that they enable the policies of parties to be effective, such donations do not directly solve social problems. In the past, donations have been given to the Government in return for political favours among other personal benefits, which subsequently occasioned heavy losses to shareholders and creditors.<sup>49</sup> The abuse of donations should be safeguarded by limiting the amount that can be given, obliging directors to disclose donations in the accounts of the company,<sup>50</sup> or requiring the consent of shareholders before giving substantial donations.

---

<sup>48</sup> Parties to the North American Free Trade Agreement (NAFTA) are prohibited from lowering health, safety, or environmental standards in order to attract investment. See NAFTA, Chapter 11, Article 1101 and onward, in Schlegelmilch, *ibid*, at 214.

<sup>49</sup> The fact that many former directors of KCC (Kenya Co-operative Creameries-in receivership) have gone on to become Members of Parliament illustrates how good KCC was as a spring board into political positions See "Politics is killing the dairy industry", *Market Intelligence Business and Finance Journal*, June 21, 2000 <[http://www.mi.co.ke/archive/september industry.html](http://www.mi.co.ke/archive/september%20industry.html)>

<sup>50</sup> In the UK companies have a statutory duty, under the s 235 of the Companies Act 1985, to disclose donations for political purposes in excess of £ 200 in the report of directors. In addition, schedule 18 of the Political Parties, Elections and Referendums Act 2000 inserted a new Part XA to the Companies Act 1985, which prohibits a company from making any donation to any political party, or to any EU political organisation, or incurring any EU political expenditure, unless the donation or expenditure is approved by the company in a general meeting.

### 10.4.3 Corruption

Company law in Kenya recognises the onerous duties of directors as fiduciaries. It obliges them to act in good faith, for the benefit of the company, and avoid conflict of interest situations.<sup>51</sup> However, in spite of these requirements it is apparent, as the empirical research shows, that corruption is a key factor contributing to breaches of fiduciary duties. When directors abuse the resources of a company through corruption,<sup>52</sup> they not only threaten the liquidity of the company, but also contribute to: stagnation of the economy, inadequate physical and social infrastructure, and poorly functioning political systems.

Given that corruption affects the well-being of both corporate entities and the economy of Kenya, companies have a collective interest in reducing corruption levels. Thus, the benefits which accrue to a company as a result of corruption cannot be "reasonably incidental to the carrying of the company's business."<sup>53</sup> A director cannot, therefore, engage lawfully in corruption to maximise the profits and, in turn, promote the prosperity of the company.<sup>54</sup> Besides, due to the illegality of corrupt practices, the constitution of a company cannot confer lawfully powers on directors to pursue such practices in the interests of the company. Due to the rampant nature of corruption, it is submitted that the responsibility of directors should be enhanced by utilising the proper purpose doctrine to ensure that any exercise of power for collateral purposes by directors is set aside for not being in the best interests of the company.<sup>55</sup>

---

<sup>51</sup> For example, in *Flagship Carriers Ltd v Imperial Bank Ltd*, op cit n 4, Mr PJS Hewett stated that directors must act: bona fide in the interest of and for the benefit of the company as a whole, for proper purposes and in a proper manner, in a sense as quasi-trustees for the company assets so that they can, for example, be held liable should they misapply any of the same, not to make secret profits, and to avoid conflicts of interests and duty.

<sup>52</sup> Section 3 of the Prevention of Corruption Act, Cap 65, Laws of Kenya, defines corruption as "receiving, agreeing to receive, or soliciting some form of material advantage from someone for the performance or non performance of their public duty. Given that this definition is only limited to public bodies and public servants, the Government has tabled a bill in Parliament, namely the Kenya Anti-Corruption and Economics Crimes Bill 2001, which seeks to widen the scope of the definition to include the private sector. See Hon A Wako, "The Kenya Anti-Corruption Bill 2001: Memorandum of Objects and Reasons",

<<http://www.lawafrica.com/specials/memorandumofobjects.htm>>

<sup>53</sup> Per Eve J in *Re Lee, Behrens and Co Ltd* [1932] 2 Ch 46 at 51.

<sup>54</sup> J Parkinson, op cit n 22, p 268.

<sup>55</sup> *Re The Highlands Commercial Union Limited* [1957] EA 851.

Since the international regulatory framework is not effective in proscribing acts of corruption and, in general breach of fiduciary duties, changes in the Kenyan law and institutional reforms of the judiciary and civil service may well not eliminate corrupt practices associated with fiduciaries. The reason for this is that the inequality of bargaining power between the State and the multinational corporations makes it possible for corporations to flout rules and discourages the Government from imposing stringent measures. The failure of the industrialised countries to oblige multinational corporations, which have a seat in their jurisdictions, to implement<sup>56</sup> the OECD Convention<sup>57</sup> also enables the corporations to engage in corrupt practices.<sup>58</sup> It is submitted that this trend should be reversed by the imposition of uniform conditions at home and in the host countries by the OECD Convention and recognition of multinational corporations as international law subjects with obligations towards good governance, environment, and society.

### 10.5 Competing with the company

To reduce instances of conflicts between the interests of the company and the duties of a director, it is important to provide expressly that a director may not engage in anything that might result in a conflict of his private interests and his duties as a director. Codifying the rules relating to use of a company's information, opportunity, and property would clarify when a director is not allowed to gain advantage unduly.

---

<sup>56</sup> "The provisions of a treaty entered into by the Government...do not become part of the municipal law...save in so far as they are made such by laws of that country." See *East African Community v R.* [1970] EA 457.

<sup>57</sup> The Convention, which criminalises foreign bribery, was passed on November 21, 1997 in the Organisation of Economic Co-operation and Development (OECD). Since the convention cannot directly pass laws, the Convention only works through committing member states to pass legislation outlawing bribery of foreign public officials. United States criminalised transnational bribery in the Foreign Corrupt Practices Act in 1977. It has also enacted the Organisation of American States' Convention against Corruption. See Gantz, "Globalizing Sanctions Against Foreign Bribery: The Emergence of a New International Legal Consensus." 18 *Northwestern Journal of International Law and Business* 282 (1997). Cited in Kimberly, "The Problem of Corruption: A Tale of Two Countries (Kenya, Uganda)", [1998] 18, 12 *Northwestern Journal of International Law and Business*, 524 at 530.

<sup>58</sup> In some countries, such as Germany and Belgium, bribes have been tax deductible. OECD Convention defines the offence of bribery as, "any intentional offer, promise or gift bestowing any undue pecuniary or other advantage, whether directly or through an intermediary to a foreign public official, for that official or for a third party in order that the official act or refrain from acting in relation to the performance of official duties in order to obtain or retain business or other improper advantage in the conduct of international business." See Low et al, "The International Anti-corruption Standards of the OECD and OAS: A Comparison with the U.S. Foreign Corrupt Practices Act." Cited in Moran, "Bribery and Corruption: the OECD Convention on Combating the Bribery of Foreign Public Officials in International Business Transactions", [1999] 8 (3) *Business Ethics: A European Review*, 141, at 143.

The definition of the terms "relevant information" and "opportunity" would need to be defined so as to assist the courts with their interpretation.<sup>59</sup> It would also be necessary to lay out the consequences for the contravention of the rules in order to make directors accountable for any benefits gained. Limiting the number of directorships<sup>60</sup> that a director may hold might also reduce the *chances of competition* with the company. It is also necessary to require a director to obtain consent from his company before he can hold more than two directorships and prohibiting executive directors from becoming non-executives of any competing companies.

### 10.6 Contracts with the company

Breaches of the duties of directors arise often when directors enter into transactions with companies. It is important to require directors to act in utmost good faith whilst transacting with a company or on its behalf. The Act requires a director who is interested in any contract to declare *the nature of his interests* at a meeting of directors.<sup>61</sup> This does not offer adequate protection to shareholders when fellow directors connive or take a lenient stand, especially if they are likely to have to disclose their own interests in the future.<sup>62</sup> Besides, this requirement becomes ineffective if contracts are not brought before the board in practice. It is therefore necessary to require directors to make such disclosures to the general meeting. Given that article 84(3) of Table A appears to exempt directors from disclosure to the general meeting, provided they disclose to their boards,<sup>63</sup> there is a need to expressly codify its meaning in order to avoid imputing the possibility of allowing directors to be in a conflict situation.<sup>64</sup> The provision ought to require expressly that

---

<sup>59</sup> Similar suggestions were made in Sheikh, *op cit* n 6, at 121.

<sup>60</sup> Multiple directorships are recognised by both the Companies Act and Table A. Section 201 requires particulars of all directorships to be contained in the register of directors and secretaries. Table A, article 78 allows a director to "become a director or other officer of, or otherwise interested in, any company promoted by the company or in which the company may be interested as shareholder or otherwise, and no such director shall be accountable to the company for any remuneration or other benefits received by him as a director or officer of, or from his interest in, such other company unless the company otherwise directs."

<sup>61</sup> Section 200 (1).

<sup>62</sup> A single director could constitute a meeting. See *Neptune (Vehicle Washing Equipment) Ltd v Fitzgerald* [1996] Ch 274.

<sup>63</sup> For differing views expressed as to the effect of s 205, see, Birds, "The Permissible Scope of Articles excluding the Duties of Company Directors" (1976) 39 MLR 394.

<sup>64</sup> Australia's Corporation Act 2001, s 199A, stipulates expressly that an officer of a company cannot be exempted from a liability to the company.

directors should not enter into a transaction in which he has an interest, unless the members have given consent.

### 10.7 Duties of Skill, Care, and Diligence

Although the Kenyan Capital Markets Authority requires directors of publicly listed companies to be familiar with basic accounting principles and be "informed, vigilant and effective overseers of the financial reporting process and the company's internal controls,"<sup>65</sup> there is no statutory provision requiring directors to have expertise and experience in the management of companies. Thus, the courts<sup>66</sup> assess their liability subjectively<sup>67</sup> by expecting them to exhibit a degree of care and skill that can reasonably be expected from persons of their knowledge and experience.<sup>68</sup> A director's knowledge, skills and experience are therefore taken into consideration when considering their liability. It is, therefore, possible for directors to go unpunished as a result of negligence arising from their ignorance or inexperience. Although this law was inherited from English law, it is notable that English case law has evolved to the point where the subjective test has been replaced by an objective one<sup>69</sup> which requires a director to possess the skill that "may reasonably be expected from a person undertaking those duties".<sup>70</sup> However, English courts still partly apply the subjective test by recognising that modern day directors are not expected to exhibit greater degree of skill than may reasonably be expected from someone undertaking such duties.<sup>71</sup> As such, English courts apply both the subjective and objective standards to assess the conduct of directors.

---

<sup>65</sup> Akumu, "Stiff New Rules for Companies", *Daily Nation*, 26 January, 2002. It is also a requirement under the London Stock Exchange, Listing Rules, paras. 3.8 However, there is no reasonable standard of general management. Directors are not under a duty to deliver services with reasonable care and skill because they are exempted from s. 13 of Supply of Goods and Services Act 1982.

<sup>66</sup> See *Flagship Carriers Ltd v Imperial Bank Ltd*, op cit n 4, 11.

<sup>67</sup> Hicks, "Directors' Liability For Management Errors", (1994) 110 LQR 390, at 390.

<sup>68</sup> Although a "foolish director" would not be liable for making foolish decisions resulting in loss to the company, he would be liable for making very foolish decisions since it is not reasonable to expect a foolish director to make very foolish decisions. See J Ogolla, *Company Law*, (Nairobi: Focus Publications, 1997) p 176.

<sup>69</sup> Professor Gower, however, argues that the test laid down by Romer J in *Re City Equitable Fire Insurance Co Ltd* is partly objective and subjective.

<sup>70</sup> Hicks, op cit n 67, at 390.

<sup>71</sup> *Theodore Goddard* [1992] BCC 14. Schedule 2, of the draft Companies Bill prepared by the UK's Company Law Steering Group requires a director to exercise the care, skill, and diligence which would be exercised by a reasonably diligent person with both the knowledge, skill, and experience which may reasonably be expected of a director in his position; and any additional knowledge, skill, and experience which he has. See para. 4; Sheikh, op cit n 6, at 88.



Whilst directors continue to abuse their duties, neither the Kenyan Parliament nor the courts have, so far, seen the need to raise the standard of care, skill, and diligence expected from directors. Assessing liability subjectively<sup>72</sup> protects miscreant directors,<sup>73</sup> as they are able to go unpunished by pleading ignorance and inexperience.<sup>74</sup> Given that there is no minimum qualification criteria set for directors, the introduction of an objective element in the assessment of their standards of skill and care would raise their standards of performance.<sup>75</sup> However, since it is not practicable to expect a director to exhibit greater degree of skill than may reasonably be expected from someone undertaking such duties,<sup>76</sup> there is a need for the court to consider the skill, knowledge, and experience of a director.<sup>77</sup> Thus, applying both the objective and the subjective tests is necessary because:

- It strikes a balance between reasonable expectations and maintains some degree of competence by considering individual circumstances of a director as well as the objective element requiring directors to have some degree of common intelligence.
- Small businessmen desirous of making independent decisions to direct their own companies would be unable to make such decisions in the event that all directors are judged by the same standards.
- Since directors with good expertise would be accountable for what they know, the general standards of conduct would improve.

---

<sup>72</sup> *Flagship Carriers Ltd v Imperial Bank Ltd*, op cit n 4.

<sup>73</sup> In *Dovey v Cory* [1901] AC 477 Cory, a director, wrongfully assented to certain payments and advances having honestly relied on the advice given by Chairman and General Manager of the bank. He was found not to be negligent of his duties after due consideration of his company's business and his position in relation to it. Similarly, Neville J in *Re Brazilian Rubber Plantations & Estates Ltd* [1911] 1 Ch 425 at 437 was of the view that directors are under a duty to exercise reasonable care having regard to their knowledge and experience, which "an ordinary man might be expected to take in the same circumstances on his own behalf."

<sup>74</sup> Nolan, "Maxwell Improper Purposes" (1994) 15 Co Law 85 at 87.

<sup>75</sup> In *Daniels and Others v Anderson and Others* (AWA case) (1995) 16 ACSR 607 at 658, the New South Wales Court of Appeal observed that old cases which imposed the subjective test and gross negligence were outdated. The subjective duty of care, skill, and diligence expected from a director was described as remarkably low.

<sup>76</sup> Modern courts in Australia and the U.K. still recognise the subsistence of the subjective element. See *Theodore Goddard* [1992] BCC 14.

<sup>77</sup> English and Australian courts apply both the subjective and objective standards to assess directors' negligence. See Ipp, "The Diligent Director" (1997) 18 Co Law 162 at 163.

Although it may be necessary to impose restrictive provisions in order to enhance the accountability of directors, it is undoubtedly the case that directors may experience difficulties whilst making decisions if they cannot establish their potential liabilities with certainty. This may, in turn, dissuade them from taking business risks. As a safeguard against such an event, courts must protect directors who make honest, informed, and rational judgements that a reasonable person in their position would make.<sup>78</sup>

Directors in Kenya are also not required to give continuous attention to the affairs of the company. Instead, competence performance by directors or their delegates in periodical board meetings suffices.<sup>79</sup> Courts in other jurisdictions have curbed neglect of duty by imposing liability for non-attendance of board meetings and entrusting delegates to carry out the affairs of the company.<sup>80</sup> It is submitted that directors ought to be required to give continuous attention to affairs of the company so as to avoid neglect which may occasion loss to a company.

### **10.8 Enforcement of Liability.**

It is evident from Chapter Five that the power of shareholders to control directors is minimal. The empirical data also shows that a clear majority (89 percent) agreed that there is no effective enforcement of liability. The law does not enable shareholders to enforce liability against miscreant directors because the corporate entity principle bars shareholders from enforcing their claims.<sup>81</sup> The company is the only body that is entitled to sue a miscreant director,<sup>82</sup> as his duties are only owed to the

---

<sup>78</sup> Australia's Corporation Act 2001, s 180 (2), provides that the standard of care under statute law is met if directors, in making business decisions inform themselves about the subject matter, make the decisions in good faith, rationally believe it is in the best interest of the company, and do not have a material personal interest in the subject matter of the subject.

<sup>79</sup> Per Romer J in *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407 at 429-9. The case formulated three principles, namely (i) the subjective test of skill which does not require a director to exhibit, in the performance of his duties, a greater degree of skill than may reasonably be expected from a person of his knowledge and experience, (ii) a director is not bound to give continuous attention to the company's affairs, (iii) a director can trust an official to perform duties that can be entrusted to him in accordance with the articles.

<sup>80</sup> *Bowman v Hammer* (1919) 250 US 504. *Kavanaugh v Gould* (1918) 223 NY 103, 199 NE 237; Nigeria Law Reform Commission, op cit n 27, p 173.

<sup>81</sup> The power to litigate in the company's name is vested in the board of directors and the general meeting. See *Musa Misango v Eria Musigire & Others* [1966] EA 390 (applying *Foss v Harbottle* (1843) 2 Hare 461).

company.<sup>83</sup> As such, the shareholders of a company whose directors form and control the majority of shareholders face enforcement difficulties because they cannot litigate in the name of the company, as the majority decision is binding on the minority. In the past, courts have been most reluctant to interfere with the internal management of companies, they have adhered to majority rule.

Whilst the exceptions to the rule enable a minority shareholder to sue in the name of the company where, for instance, the majority is committing a fraud on the minority, a shareholder is still required to discharge the onus of establishing fraud.<sup>84</sup> Thus, although the enforcement restrictions<sup>85</sup> imposed on minority shareholders by the rule in *Musa Misango v Eria Musigire & Others*,<sup>86</sup> preserve the corporate and collective nature of the company, they restrict the power of the individual shareholder to enforce the rights of a company.

Whilst statutory provisions enable any member of a company who complains of the oppressive nature of the conduct of the affairs of the company on some part of the membership to make an application to the court by petition for an order,<sup>87</sup> the remedy is too restrictive since a shareholder has to prove that a defendant has overwhelming control<sup>88</sup> of the company and that "the facts would justify the making of a winding up order on the ground that it was just and equitable that the company should be wound up."<sup>89</sup> Given that the courts interpret the notion of "oppression" in a narrow sense,<sup>90</sup> there is a heavy onus of proof placed on minority shareholders

---

<sup>82</sup> Proceedings may be instituted against a de facto or shadow director as well as a retired director, estate of a deceased director, and a bankrupt director. See *Curtis's Furnishing Stores Ltd v Freedman* [1966] 2 All ER 955. Proceedings may be instituted in the name of the company on the authority of the board of directors or the General Meeting. See Article 80, Table A of the Act.

<sup>83</sup> *Musa Misango v Eria Musigire & Others*, op cit n 81.

<sup>84</sup> Although the courts in the United Kingdom have accepted that the term 'fraud' may cover breaches of duty, intentional acts of discrimination, and unintentional abuses of corporate power, it is not certain whether Kenyan courts would adopt a similar definition. See *Knight v Frost* [1999] 1 BCLC 364.

<sup>85</sup> The restrictions are aimed at discouraging wasted litigation, discouraging multiple actions, and underscoring the principles of majority rule and separate legal personality.

<sup>86</sup> [1966] EA 390.

<sup>87</sup> The Act, s 211.

<sup>88</sup> *Birch v Sullivan* [1957] 1 WLR 1247.

<sup>89</sup> Section 211 (1) (b), The Act. For an illustration of how onerous it is to prove that it is just and equitable to wind up a company under section 211 see *Mohamed Mitha and Others v Ibrahim Mitha and Others* [1967] EA 575 and *Sverre Haug and Others v Buhemba Mines* (1953) 20 EACA 28. If the court is convinced that it is just and equitable to wind up the company the shareholders have to convince the court to grant the oppressive conduct remedy rather than the winding up order. See *Re Bellador Silk Ltd* [1965] 1 All ER 667.

which makes it easy for miscreant directors to escape liability when they form and control the majority of the shareholders.<sup>91</sup> It is also possible for directors to escape liability if what is complained of is an omission, threatened future conduct or a single instance of an oppressive conduct, rather than a continuing course of oppressive conduct.<sup>92</sup>

The UK's Companies Act 1985<sup>93</sup> has replaced the notion of "oppression" and allowed a shareholder to bring action if the conduct of directors constitutes "unfairly prejudicial conduct". This remedy is better than the Kenyan one because a single event which may be an act, an omission, or threatened future conduct is sufficient to constitute unfairly prejudicial conduct.<sup>94</sup> Importantly, the act complained of does not have to satisfy the grounds for the granting of a winding up order on the just and equitable ground. In addition, the terms "unfair" and "prejudice" have a wide scope and it is not necessary to prove that the act complained of was conducted in bad faith.<sup>95</sup> It is submitted that the Kenyan statutory oppression remedy should be made more effective by abolishing the need to prove that the defendant has *overwhelming* control and that it is just and equitable to wind up the company.<sup>96</sup>

Although section 211 of the Act enables a member or the Attorney-General<sup>97</sup> to apply for court relief as a result of oppressive nature of the conduct of the affairs of the company, the section cannot be invoked as a result of hardship suffered by

---

<sup>90</sup> Conduct is regarded as oppressive if it is burdensome, harsh, and wrong. See *Scottish Competitive Co-operative Wholesale Society Ltd v Meyer* [1959] AC 324.

<sup>91</sup> To sue under the minority oppression head, shareholders have to prove a defendant's overwhelming control of the company.

<sup>92</sup> Clark, "Unfairly Prejudicial Conduct: A Pathway Through the Maze", (2001) 22 (6) Co Law 170, 171.

<sup>93</sup> Section 459 (1).

<sup>94</sup> Clark, *op cit* n 92, at 171

<sup>95</sup> *Re RA Noble & Sons (Clothing) Ltd* [1983] BCLC 273. The breach of constitution and legitimate expectations can be a ground for a claim under the section.

<sup>96</sup> In New Zealand, for instance, shareholders are no longer required to show lack of probity or want of good faith on the part of directors. This has been made possible by the liberalised approach adopted by the courts following enactment of section 174 of the Companies Act 1993. Although the liberalised approach enhanced shareholders' rights to remedy personal wrongs, it did not enhance shareholders' ability to enforce corporate causes of action. Berkahn, "Derivative Action in Australia and New Zealand", (1998) 10 Bond LR 74 at 91; *Thomas v HW Thomas Ltd* [1984] 1 NZLR 686 at 693.

<sup>97</sup> The Attorney-General is empowered to petition when the case falls under section 170 (2), which allows the Attorney General to petition for a winding-up order.

directors, employees, creditor, or debenture-holder, where they are not members.<sup>98</sup> Similarly, the remedy under section 459 of the UK's Companies Act 1985 is limited in scope because the only persons who can invoke the section are members of a company or a person to whom shares have been transferred or transmitted by law.<sup>99</sup> In contrast, the Canadian Business Corporation Act<sup>100</sup> regards a registered holder or beneficial owner, and a former registered holder or beneficial owner of a security of a company as being able to qualify as complainants for the purposes of applying for judicial relief as a result of oppressive conduct. The court can grant judicial relief if such a complainant satisfies the judge that some oppressive conduct has unfairly prejudiced the interests of any security holder, creditor, director, or officer.<sup>101</sup>

The class of persons covered by the term “members” for the purposes of *suing on* behalf of the company, where affairs are being conducted in an oppressive manner, in Nigeria includes “persons who have suffered or are likely to suffer from conduct which is prejudicial to their interests.”<sup>102</sup> Other persons included in the definition of a member include:

- "The personal representative of a deceased member
- Any person to whom shares of a member have been transferred or transmitted by operation of law
- A director or an officer or former director or officer of the company
- A creditor of the company
- The Corporate Affairs Commission in a case where the Commission has received any adverse reports on the conduct of affairs of any company as a result of any investigation

---

<sup>98</sup> Section 26 of the Act refers to members as subscribers to the memorandum of association who become members on its incorporation. It also refers to any other person who agrees to become a member and whose name is entered in the register. In *Re Jermyn Street Turkish Baths Ltd* (1970) 3 All ER 57 at 67, the term member was interpreted to include a deceased member's personal representative. Also see *Re Lundie* (1965) 2 ER 692.

<sup>99</sup> For a detailed analysis of the effectiveness of section 459 in the UK see Clark, op cit n 92, at 171.

<sup>100</sup> Section 247 (2).

<sup>101</sup> Lowry, "The Oppression Remedy: A Canadian Approach", [1991] JBL 196, 196.

<sup>102</sup> Nigeria Law Reform Commission, op cit n 27, p 237

carried out by it; and any other person who in the discretion of the court, is a proper person."<sup>103</sup>

Whilst it can be argued that allowing a shareholder of a related body corporate to make an application regarding a company in which he has no stake is undesirable,<sup>104</sup> there can be no doubt that there is a need to widen the class of persons that can seek a remedy from the court. Since creditors may also petition the court for winding-up orders on such grounds, they should also be empowered to seek relief under this section. Although it may be argued that such a step would open a floodgate of claims, the assertion can be refuted if the institution of proceedings depended on securing the leave of the court, for the courts would be able to strike out frivolous claims at the leave stage.

Although there is a need to preserve the collective nature of corporate decision-making and to prevent mass shareholder litigation on any matter with which the shareholders are dissatisfied, there can be no doubt that the need to sustain accountability demands expedient enforcement of the duties of directors. The present position is skewed towards the preservation of corporate entity rather than enforcement of liability. It is necessary to strike a balance between the two interests because appropriate corporate governance can hardly be realised unless a legal system has in place a mechanism that facilitates prompt and expedient resolution of disputes within a company. Enabling shareholders to enforce the rights of the company more readily would be a safeguard against the tendency of directors to escape liability. For instance, shareholders would be adequately protected if they are enabled to litigate in the name of the company without having to discharge the heavy onus required to establish that directors have overwhelming control of the company.

---

<sup>103</sup>Ibid p 247.

<sup>104</sup>McDonough, "Proposed New Statutory Derivative Action-Does it go Far Enough?" (1996) 8 Bond LR 47 at 58.

It is submitted that Kenya ought to follow other jurisdictions which have opted not to apply the rule in *Foss v Harbottle* when it stands in the way of justice.<sup>105</sup> Although the Kenyan Capital Markets Authority now requires public listed companies to have "a mechanism for representation of minority shareholders without undermining the collective responsibility of the directors,"<sup>106</sup> shareholders are still not in a position to enforce the rights of a company where directors form and control a majority of the votes. It is thus necessary to have a statutory provision enabling minority shareholders to enforce the rights of the company.<sup>107</sup> For instance, a statutory derivative action would enable a shareholder to bring an action on behalf of a company if the company is unwilling to invoke its litigation powers. Whilst it may well be argued that a statutory derivative action would interfere unduly with the decision making role of the board, there can be no doubt that the courts would assess the extent to which a decision of the board should be challenged.<sup>108</sup> As a safeguard against frivolous suits by shareholders, it is submitted that persons invoking the derivative action should seek leave of the court in order to establish their bona fides, inaction of the company, whether the action is in the best interests of the company, and whether there is a serious issue to be tried.<sup>109</sup>

Shareholders should be given more powers to enforce the liability of directors by relaxing the inspection and investigation provisions under the Act. The Act enables a court to appoint one or more competent inspectors to investigate or inspect the affairs of a company having a share capital, if an application is made by either more than 200 members or members holding not less than one tenth of the shares issued.<sup>110</sup> In the case of a company not having a share capital, the application ought to be made by more than one-fifth in the number of persons on the company's

---

<sup>105</sup> The Corporate Law Economic Program Act 1999 of Australia inserted a right to bring a "statutory derivative action" as Pt 2F 1A of Australia's Corporations Act. Companies Act 1993 of New Zealand has a similar provision. See s 165.

<sup>106</sup> Akumu, "State Control Blamed for Problems in Privatising Telecoms Companies", *Daily Nation*, 8 March, 2002.

<sup>107</sup> Courts in other jurisdictions, such as Australia and New Zealand, have shown the tendency of not applying the rule in *Foss v Harbottle* when it stands in the way of justice. See Pt 2F 1A of Australia's Corporations Act 2001; The Companies Act 1993 of New Zealand, s 165; and *Thomas v HW Thomas Ltd* [1984] 1 NZLR 686 at 693.

<sup>108</sup> Paton, *op cit* n 29, 315.

<sup>109</sup> These are some of the grounds that have to be satisfied before a person can get leave of the court in Australia to pursue a statutory derivative action. See s 237 Corporation Law 2001.

<sup>110</sup> Section 165 (1) (a)

register of members.<sup>111</sup> It is evident that a shareholder who is incapable of mustering the required majority cannot make an application under this section. As a result, he would not be able obtain documentary evidence for the purposes of taking action against directors. As it stands, the provision is too stringent and ought to be relaxed in order to accommodate more investigations. Alternatively, shareholders should be entitled to have access to relevant documents.<sup>112</sup>

Given that a member is required to provide the registrar with *security for costs* when he wishes the affairs of the company to be investigated,<sup>113</sup> it is submitted that this requirement should be abolished because it deters a member who is unable to provide the security for costs from pursuing individual suits.<sup>114</sup> Although this requirements helps to prevent frivolous and vexatious claims, a public body with a mandate to investigate the affairs of companies would be better suited to investigate the claims made by individuals in order to pursue the genuine ones.

### 10.9 Parastatals

The poor performance of parastatals is attributable to the failure of the state, as an owner of enterprises, to motivate the firms to realise competitive business standards.<sup>115</sup> It is evident from the empirical data that inadequate management controls contributed substantially to the poor performance of parastatals. This was supported by 94 percent of respondents in the empirical study. It is also the case that divesting the interests of the State in parastatals through privatisation would improve accountability (91 percent supported this).

It is apparent that the State Corporations Act<sup>116</sup> politicises the appointment of directors by vesting the powers of appointment in the President<sup>117</sup> and the

---

<sup>111</sup> Ibid.

<sup>112</sup> The USA has removed the common law position of non-accessibility. See Nigeria Law Reform Commission, op cit n 27, p 249.

<sup>113</sup> The security required in Kenya amounts to Kshs 10, 000 (£ 100).

<sup>114</sup> The Nigerian Law Reform Commission also recommended the relaxation of Nigeria's inspection and investigation provisions on the grounds that they barred many shareholders from enforcing directors' liability. See sections 157-167 of the Nigerian Companies Act 1968.

<sup>115</sup> S Estrin, "State Ownership, Corporate Governance, and Privatisation", in OECD, *OECD Proceedings: Corporate Governance, State Owned Enterprises and Privatisation*, (Off Pubns OEEC 2781, 1998), p 11.

<sup>116</sup> Cap 446, Laws of Kenya.

<sup>117</sup> S 6 (1) (a), the President appoints the chairman.



Minister.<sup>118</sup> The appointees therefore act in the interests of their appointors rather than the corporation. It is submitted that this trend can be reversed by requiring all appointments to be made by an independent body, such as Parliament.

Excessive regulations coupled with extensive ministerial intervention in the functioning of the boards impair their ability to make commercially sound decisions and enforce accountability. For instance, the inability of the board to dismiss executive officers renders difficult the task of imposing performance levels and sanctions.<sup>119</sup> This is because parastatals are governed by overlapping laws and regulations. Although each parastatal is governed according to the Act of Parliament under which it was established, they are all governed under the State Corporations Act<sup>120</sup> and the administrative circulars which are issued frequently by the office of the President and the Ministers. The lack of powers to impose sanctions on the Chief Executive and other senior executive also limits the ability of boards of parastatals to meet their goals. Given that companies can hardly achieve efficiency unless directors are given the autonomy to steer the companies forward,<sup>121</sup> it is submitted that the interests of the State in parastatals should be divested in order for the board of directors to function effectively.

Although privatisation of parastatals would give the board of directors autonomy, and in turn, increase efficiency by reducing political influence,<sup>122</sup> the transfer of property rights to new owners does not necessarily guarantee that sound corporate governance structures and processes are established and sustained.<sup>123</sup> Thus, there is a need to have in place effective regulations that would not only guide the privatisation process but also protect the privatised corporations from abuse.<sup>124</sup> Such legislation would reduce political and social costs which are borne as a result of

---

<sup>118</sup> S 6 (1) (e), the minister appoints the Chief Executive Officer and other members of the board.

<sup>119</sup> Chief executives, as appointees of the President, can only be sacked by the President. World Bank, *Bureaucrats in Business; The Economics and Politics of Government Ownership*, Washington DC 1995 at 14 in McDonough, "Corporate Governance and Government Owned Corporations in Queensland", (1998) 10 Bond LR 272 at 309.

<sup>120</sup> The Act attempts to bring all corporations under one uniform law.

<sup>121</sup> S Sheikh and W Rees, op cit n 24.

<sup>122</sup> Kenya Airways became competitive and profitable after privatisation. See "KR to go Public, Government Says", *Daily Nation*, March 15, 2000.

<sup>123</sup> "Transparency Required in the Privatisation of the Sugar Industry", *East African Standard*, 16 October, 2001.

having unclear rules regarding the selection of buyers. In the past, parastatals have been sold at discounted prices to politicians.<sup>125</sup> Moreover, privatisation of some parastatals, such as Telkom Kenya, has stalled because of a failure on the part of politicians to agree on the shareholdings in the privatised corporation.<sup>126</sup> It is submitted that the privatisation process should be governed by an autonomous body which is answerable to a body, such as Parliament, that cannot be easily the subject of interference.

#### 10.10 Self regulation

Despite the pressure on the Kenyan Government to reduce its intervention in the economy, self-regulatory codes are likely to have little utility in themselves because of the possibility of directors *not being effective in policing themselves*. As the empirical data in Chapter 9 shows, a majority of the respondents preferred statutory control to self-regulation. The empirical data shows that a majority of the respondents (69 percent) were actually against<sup>127</sup> self-regulatory codes.<sup>128</sup> It is notable that due to corruption and lack of a strict mechanism to enforce the codes of discipline, the use of self-regulatory codes by professional societies in Kenya has been largely ineffective.<sup>129</sup> In fact, responses to Question 7 of the survey questionnaire indicated that most professional bodies do not strictly observe rules and regulations. A few of those mentioned in the responses were the Law Society of Kenya, the Kenya Institute of Management, and the Kenya National Chamber of Commerce & Industry. It is submitted that statutory control of directors would have more effect in Kenya than self-regulation. Under the current system, a self-regulatory regime ought to be supplemented by strict government regulation until such a time that it is possible to have an effective full self-regulation regime.

---

<sup>124</sup> Few indigenous Kenyans have bought the privatised firms to date. See "Parastatal Bosses are Political Retirees", *The East African*, April 24, 2000.

<sup>125</sup> Kisero, "Meddlers to be Shut out of State Firms", *Daily Nation*, 28 May, 2002.

<sup>126</sup> Kisero, "New Law may Stymie the Vultures", *Daily Nation*, 29 May 2002.

<sup>127</sup> The Kenyan Parliament recently disagreed with the wishes of the Treasury, the World Bank and the IMF by passing a bill limiting the interest rates of banks. See "Welcome to Kenya, IMF's Little Colony", *Daily Nation*, 20 May, 2001.

<sup>128</sup> The implementation of the International Accounting Standards (IAS) has been criticised on the basis that the standards are only favourable towards foreign owned multinational banks as Kenya's banks were constrained by the short term nature of Kenyan deposits. Another reason advanced against the IAS was that the Kenyan judicial system discourages the quick dispensation of commercial cases. See "Banker, NSE Chief Riled by IAS", *East African Standard*, 17 May, 2001.

<sup>129</sup> Rugene, "AG Praises Efforts to Keep Media Discipline", *Daily Nation*, 8 May, 2002.

### 10.11 Disqualification

The empirical data reveals that disqualification orders are very rare and that a stricter disqualification<sup>130</sup> regime would ensure that unfit directors do not serve on boards.<sup>131</sup> A stricter disqualification regime would protect the public by placing prohibitions on errant directors being involved, for a specific period, in the management of companies. As well as preventing people without the necessary qualifications from managing companies, disqualification orders may also serve as a deterrent to those who might be tempted to engage in fraudulent and improper activities, and those who are unfit to act.

Whilst a director can be disqualified for breaches of duty when a company is in the course of winding up,<sup>132</sup> fraud needs to be proven against the director when the company is a going concern.<sup>133</sup> As such, a director in Kenya cannot be disqualified for being unfit to be involved in the management of a company.<sup>134</sup> This is to be contrasted with the UK<sup>135</sup> and Australia.<sup>136</sup> Directors in Australia<sup>136</sup> and New Zealand can also be disqualified for acting dishonestly, failing to exercise reasonable care, and acting in an incompetent manner.<sup>137</sup> Given that the duty of proving fraud in Kenya is onerous,<sup>138</sup> the remedy of disqualification on grounds of fraudulent trading

---

<sup>130</sup> Disqualification of directors protects the public by placing a prohibition on the errant director being involved, for a specific period, in the management of companies. See S Mayson et al, *Company Law*, 17<sup>th</sup> Edition (Blackstone, 2000) p 679.

<sup>131</sup> Eighty nine percent of the respondents felt that there is little chance of directors being sued for breach of duties when companies enter liquidation. Ninety-two percent of the respondents also felt that directors' disqualification orders are extremely rare. Ninety-eight percent agreed with the statement that an effective disqualification regime of directors would promote standards of corporate governance.

<sup>132</sup> Under section 189 (1) (b) (ii) a director may be disqualified for fraud or breach of duty if the company is in the course of winding up. A bankrupt is also precluded from being a director under section 188.

<sup>133</sup> Section 189 (1).

<sup>134</sup> Explaining what makes a person unfit in the UK, Browne Wilkinson VC said in *Re Lo Line Electric Motors Ltd* [1988] 3 WLR 26, "Ordinary commercial misjudgement is in itself not sufficient to justify disqualification. In the normal case, the conduct complained of must display a lack of commercial probity, although I have no doubt that in an extreme case of gross negligence or total incompetence disqualification could be appropriate."

<sup>135</sup> Section 6 of the UK's CDDA. Also see *Re Barings Plc (No 5)* [1999] 1 BCLC 433; *AB Trucking and BAW Commercials* (Ch D June 1987; Dine, "Disqualification of Company Directors" (1988) 9 Co Law 213.

<sup>136</sup> Whilst determining whether to disqualify a directors the Australian courts take into consideration a director's conduct in relation to the management, business or property of any corporation. See s 206 E (2). For UK, see section 8 of the Company Directors Disqualification Act 1986 ("CDDA").

<sup>137</sup> New Zealand's Companies Act 1993, s 383.

<sup>138</sup> *Kassam Ebrahim v Tait* [1935] EACA 51.

is somewhat insufficient. It is submitted that directors should be disqualified on the basis of wrongful acts rather than fraud.

Directors who have been responsible for the insolvency of several companies in Kenya are not precluded from acting as directors,<sup>139</sup> unless they have been disqualified following bankruptcy<sup>140</sup> or conviction for fraud.<sup>141</sup> It is necessary to bar such directors from assuming other directorships for a specified time in order to safeguard against abuse of companies that they might mismanage.

In Kenya, the failure to file annual returns by directors only makes them liable to a fine,<sup>142</sup> while in Australia,<sup>143</sup> directors can be disqualified for up to five years for being in default of filing returns with the Australian Securities and Investments Commission. It is necessary to adopt this ground of disqualification in Kenya because it would enable shareholders to keep track of the activities of a company more effectively.

Under section 189 of the Act a disqualified director is precluded from being involved in the management of companies for a period not exceeding five years. Other jurisdictions have recognised the need for longer periods of disqualification. For instance, Australian courts can disqualify a person from managing corporations for a period that the Court considers appropriate.<sup>144</sup> The UK's Company Directors Disqualification Act 1986 ("CDDA") imposes a minimum disqualification of two years and a maximum of fifteen years.<sup>145</sup> It is submitted that longer periods of

---

<sup>139</sup> Section 323 of the Act imposes personal liability for debts of the company and other liabilities on those persons who were knowingly party to fraud.

<sup>140</sup> The Act, section 188 (1). Under section 189 of the Act, a disqualified director is precluded from being involved in the management of companies for a period not exceeding five years. The UK's CDDA 1986 imposes a minimum disqualification of two years and a maximum of fifteen years for unfit conduct.

<sup>141</sup> The Act, section 189 (1). It is an offence in the UK for a director of a wound up company, within five years, to be a director or concerned in the management of a company known by the same name or so similar a name to suggest an association with the liquidating company. See section 216, Insolvency Act 1986.

<sup>142</sup> Section 125 (3), The Act.

<sup>143</sup> Corporations Act 2001, sections 4, 10, 285.

<sup>144</sup> Corporations Act 2001, sections 206C and 206 E.

<sup>145</sup> In assessing the appropriate length of the disqualification order, the court considers; the nature of the offence, whether it was closely connected with management, nature of the person's involvement in the offence, his general character and reputation etc. See Hicks, "Making and Resisting Disqualification Orders" (1987) 8 (6) Co Law 243 at 246.

disqualification should be imposed so as to deter miscreant directors and keep them away from boardrooms for longer periods.

The lack of a register of disqualification orders in Kenya makes it impossible to enforce disqualification orders when a director continues to act secretly. It is important to have such a register because it facilitates effective enforcement of disqualification orders and brings to light any disqualified director. This would enable creditors and the general public to be able to know that a person is disqualified and, therefore, register their protests when a disqualified person manages a company.<sup>146</sup>

In sum, broadening the scope of disqualification provisions, offences, and grounds covered by the Act would prevent miscreant directors finding their way to, or remaining in, boardrooms.

## **10.12 Conclusions**

The codification of the duties of directors, as well as the other provisions suggested above, would not only simplify the legal requirements, but also their presentation. It would provide an opportunity to clarify and broaden the rules and provisions that are unclear and restrictive. This would allow directors and the stakeholders of the company to understand more easily the duties and responsibilities of directors. The understanding would, in turn, be likely to enhance the performance of directors and promote shareholder activism. All these are necessary ingredients of an appropriate and robust corporate governance system.

---

<sup>146</sup> The Ghanaian Code, s 186, requires the Registrar to publish a register of disqualified persons in the Gazette and maintain it for the purposes of public inspection. Similarly, the UK Secretary of State maintains a register of disqualification orders, which is open to inspection free of charge. Section 18, CDDA 1986 provides that the register can be inspected at the Companies House in London within fourteen days of making a disqualification order. The court sends the particulars of the order to the Secretary of State for entry in the register. In addition any variation and grant of leave to act must be communicated to the Secretary of State. See S Mayson, *op cit* n 130, p 727.

## CHAPTER ELEVEN

### 11.0 CONCLUSIONS

This thesis has demonstrated that in spite of the important role played by a limited liability company in enabling capital to be accumulated and invested in risk-taking enterprises, the ability of the company to contribute positively to the economy is constrained by ineffective regulation of directors. The poor performance of a vast majority of companies and the Kenyan economy is traceable to the poor and, in some cases, fraudulent performance of boards of companies. The current regulatory framework, whose origin can be traced back to the colonial government, is not only inadequate, but also too outdated to serve the interests of modern day companies and a modern society. In spite of the outdated and ineffective nature of the law, external factors, such as corruption, have also militated against the proper performance of directorial duties. The corrupt political system has contributed to the failure to safeguard social and economic rights of Kenyans. This in turn explains why the Government has failed to protect the interests of stakeholders of companies and enforce the liability of miscreant directors effectively. Such protection can be achieved by reforming both the environment within which companies operate and the Companies Act (the "Act") in order to raise the levels of accountability and responsibility of directors.

Although the Act and rules of common law define the obligations of directors, they contain rules that are cumbersome and difficult to understand. Therefore, this constitutes a barrier to directors knowing what is expected of them. Since the ability of Kenyan courts to develop the law might be hampered by external factors, such as lack of resources to purchase law reports, the law relating to directors should be codified in order for the courts and other interest groups to have easy grasp of the duties and responsibilities of directors.<sup>1</sup> Although codification would not necessarily

---

<sup>1</sup> In the UK, it has been proposed that a statutory statement should be formulated to make the doctrine useful as a guide to directors. See DTI, The Company Law Review Steering Group: Final Report: Final Report, 2001, p 41; Company Directors: Regulating Conflicts of Interest and Formulating a Statement of Duties (Law Commission Consultation Paper No 153, London: Stationery Office, 1998), Part 15.

dispense with the need to seek statutory interpretation from case law, it is undoubtedly the case that it would make the law more accessible. In addition to making the law accessible, it is necessary for directors who do not have the requisite knowledge to undergo some significant training in order to perform effectively. This is likely to raise the levels of corporate governance by enhancing the competence of directors and the activism of shareholders.<sup>2</sup>

Although the duties of directors are owed to the company itself, this thesis has demonstrated the need for the duties of directors to include a wider constituency than that of shareholders. Whilst it may be argued that the ultimate objectives of companies are to generate maximum value for shareholders,<sup>3</sup> this thesis has shown that maximising shareholder value does not achieve maximum prosperity and welfare of the society.<sup>4</sup> As such, it is necessary for directors to weigh the interests of stakeholders against the immediate interests of the company when making decisions because companies can enhance their long-term productivity by sacrificing profits in the short term.<sup>5</sup> Failure to do that may, for instance, result in widespread consumer activism in the global market which would damage the reputation of a company that is not socially responsible. Requiring directors to take social responsibilities into account would also reduce the abuse of the economic and social power<sup>6</sup> of multinational corporations. Given that multinational corporations use their powers to out-negotiate the Government in transactions, there is a need for fair rules on investment which would act as a safeguard against abuse of power.<sup>7</sup> The reason for

---

<sup>2</sup> United Kingdom's Department of Trade and Industry has leaflets that are designed to promote awareness. See <<http://www.dti.gov.uk>>

<sup>3</sup> This is the enlightened shareholder approach. See Blair M, *Ownership and Control: Rethinking Corporate Governance for the twenty-first Century* (1995). Cited in The Company Law Review Steering Group, *Modern Company Law for a Competitive Economy: The Strategic Framework*, February 1999, p 31; J Parkinson, *Corporate Power and Responsibility*, (Clarendon Press, 1993) p 260.

<sup>4</sup> This is the pluralist approach. See M Blair, *Ownership and Control: Rethinking Corporate Governance for the twenty-first Century* (1995). Cited in The Company Law Review Steering Group, *Modern Company Law for a Competitive Economy: The Strategic Framework*, February 1999, p 31.

<sup>5</sup> Paton, "Codification of Corporate Law in the United Kingdom and European Union: The Need for the Australian Approach", [2000] 11 (9) ICCLR 309, 316.

<sup>6</sup> A Drzemczewski, *European Human Rights Convention in Domestic Law* (Oxford University Press, 1983) Ch 8. Cited in Muchlinski, "The Accountability of Multinational Enterprises and the Right to Development: The Compensation of Industrial Accident Victims from Developing Countries," [1993] *Third World Legal Studies*, 189 at 191.

<sup>7</sup> Schlegelmilch R, "WTO: Why Still No Multilateral Rules for Foreign Direct Investment", [2000] 6 (3) *International Trade Law and Regulation*, 78, 78.

this is that the present day rules developed by the World Trade Organisation (WTO) are more protective of foreign investors than the host countries.

In spite of the considerable benefits that are likely to be drawn from the assumption of social responsibilities by directors, it is still important to have effective regulation in place because some undertakings, such as the giving of donations, are likely to be abused by miscreant directors. Due to the rampant nature of corruption in Kenya, it is not unlikely for donations to be given to politicians in return for political favours.<sup>8</sup>

Although Kenyan company law obliges directors to act in good faith, for the benefit of the company, and avoid conflict of interest situations,<sup>9</sup> there is a litany of breaches of duties by directors, especially when they engage in corruption. Since corruption affects the well-being of both corporate entities and the economy of Kenya, companies have a *collective interest in reducing corruption levels*. Thus, the benefits which accrue to a company as a result of corruption cannot be "reasonably incidental to the carrying of the company's business."<sup>10</sup> A director cannot, therefore, engage lawfully in corruption to maximise the profits and, in turn, promote the prosperity of the company.<sup>11</sup> Besides, due to the illegality of corrupt practices, the constitution of a company cannot lawfully confer powers on directors to pursue such practices in the interests of the company.

Local and international initiatives are needed to eliminate the problem of corruption in Kenya. This is because powerful and influential foreign investors are also active participants in corruption. Moreover, the inequality of bargaining power between the State and multinational corporations may also discourage the Government from imposing stringent measures. Therefore, there is a need for Western countries to oblige multinational corporations, which have a seat in their jurisdictions, to

---

<sup>8</sup> The fact that many former directors of KCC (Kenya Co-operative Creameries-in receivership) have gone on to become Members of Parliament illustrates how good KCC was as a spring board into political positions. See "Politics is killing the dairy industry", *Market Intelligence Business and Finance Journal*, June 21, 2000 <[http://www.mi.co.ke/archive/september industry.html](http://www.mi.co.ke/archive/september%20industry.html)>

<sup>9</sup> In *Flagship Carriers Ltd v Imperial Bank Ltd*, High Court Civil Case No 1643 of 1999 (Unreported), Mr PJS Hewett stated that directors must act: bona fide in the interest of and for the benefit of the company as a whole, for proper purposes and in a proper manner, in a sense as quasi-trustees for the company assets so that they can, for example, be held liable should they misapply any of the same, not to make secret profits, and to avoid conflicts of interests and duty.

<sup>10</sup> Per Eve J in *Re Lee, Behrens and Co Ltd* [1932] 2 Ch 46 at 51.



implement<sup>12</sup> the OECD Convention<sup>13</sup> which proscribes corrupt practices.<sup>14</sup> The presence of uniform conditions at home and in the host countries would go a long way towards reducing corruption.

The extent to which directors have failed to meet levels of reasonable diligence, good faith, and honesty has been demonstrated in this thesis. Reforms that are protective of the public interest are needed in order to raise levels of responsibility and accountability in the performance of directorial duties.

Conflicts between the interests of the company and the duties of a director can be reduced by expressly providing that a director may not engage in anything that might result in a conflict of his private interests and his duties as a director. It is therefore important to codify the common law rules relating to use of a company's information, opportunity, and property. This would clarify when a director is not allowed to gain advantage unduly. Directors also ought to be required to act in utmost good faith whilst transacting with a company or on its behalf, in order to prevent breaches of duty which arise when directors enter into transactions with

---

<sup>11</sup> J Parkinson, op cit n 3, p 268.

<sup>12</sup> "The provisions of a treaty entered into by the Government...do not become part of the municipal law...save in so far as they are made such by laws of that country." See *East African Community v R*. [1970] EA 457.

<sup>13</sup> The Convention, which criminalises foreign bribery, was passed on November 21, 1997 in the Organisation of Economic Co-operation and Development (OECD). Since the convention cannot directly pass laws, the Convention only works through committing member states to pass legislation outlawing bribery of foreign public officials. United States criminalised transnational bribery in the Foreign Corrupt Practices Act in 1977. It has also enacted the Organisation of American States' Convention against Corruption. See Gantz, "Globalizing Sanctions Against Foreign Bribery: The Emergence of a New International Legal Consensus." 18 *Northwestern Journal of International Law and Business* 282 (1997). Cited in Kimberly, "The Problem of Corruption: A Tale of Two Countries (Kenya, Uganda)", [1998] 18, 12 *Northwestern Journal of International Law and Business*, 524 at 530.

<sup>14</sup> In some countries, such as Germany and Belgium, bribes have been tax deductible. OECD Convention defines the offence of bribery as, "any intentional offer, promise or gift bestowing any undue pecuniary or other advantage, whether directly or through an intermediary to a foreign public official, for that official or for a third party in order that the official act or refrain from acting in relation to the performance of official duties in order to obtain or retain business or other improper advantage in the conduct of international business." See Low et al, "The International Anti-corruption Standards of the OECD and OAS: A Comparison with the U.S. Foreign Corrupt Practices Act." Cited in Moran, "Bribery and Corruption: the OECD Convention on Combating the Bribery of Foreign Public Officials in International Business Transactions", [1999] 8 (3) *Business Ethics: A European Review*, 141 at 143.

companies. It is also important to limit the number of directorships<sup>15</sup> that a director may hold in order to reduce the chances of competition with the company.

Given that modern day directors have to operate within a business environment which has become more sophisticated because of technology and globalisation, the Kenyan Parliament and courts have to play an active role in the internal management of companies so as to protect shareholders. This is because the rising standards of the global economy demand higher standards in the performance of directorial duties. Raising the standards of performance would protect shareholders who are often not in a position to track continuously the conduct of directors. Chapter Four has shown that it is possible for directors to go unpunished as a result of negligence arising from their ignorance or inexperience because the courts assess their liability subjectively. Introducing an objective element in the assessment of directorial duties would raise standards because directors would be expected to possess the skill that “may reasonably be expected from a person undertaking those duties”.<sup>16</sup> However, the need to apply subjective standards cannot be ignored because a board consists of directors with diverse qualifications and experiences. Besides, it is not practicable to expect a director to exhibit a greater degree of skill than may reasonably be expected from someone undertaking such duties.<sup>17</sup> This explains why it is important to apply both the subjective and objective standards to assess directors’ conduct.

A corporate governance mechanism that facilitates prompt and expedient resolution of disputes within a company raises the levels of responsibility and accountability. Failure to have such a mechanism in place is likely to result in dissipation of the resources of the company and time in protracted litigation. Since the power of

---

<sup>15</sup> Multiple directorships are recognised by both the Companies Act and Table A. Section 201 requires particulars of all directorships to be contained in the register of directors and secretaries. Table A, article 78 allows a director to “become a director or other officer of, or otherwise interested in, any company promoted by the company or in which the company may be interested as shareholder or otherwise, and no such director shall be accountable to the company for any remuneration or other benefits received by him as a director or officer of, or from his interest in, such other company unless the company otherwise directs.”

<sup>16</sup> Per Hicks, “Directors’ Liability For Management Errors”, (1994) 110 LQR 390, at 390. Also see *Norman v Theodore Goddard* [1991] BCLC 1028 where Hoffmann J observed that “a director who undertakes the management of the company’s properties is expected to have reasonable skill in property, but not in off shore tax avoidance.”

shareholders to control directors is limited, shareholders cannot be adequately protected unless they are able to recover moneys due to them and also recoup losses suffered by them as a result of the action of directors. The powers of shareholders to enforce the liability of directors is limited by the corporate entity principle which bars shareholders from enforcing their claims. This is because the company is the only body that is entitled to sue a miscreant director, as his duties are only owed to the company. Since the courts are reluctant to interfere with a majority decision, the shareholders of a company whose directors form and control the majority of shareholders face enforcement difficulties because they cannot litigate in the name of the company.

There is a need to respect the decision of majority shareholders because interfering with their decision would make investors believe that the only changes that would be binding for a company are those that are supported unanimously. Investors would hardly be attracted to a company with such a policy because of the trust they have in voting as a mechanism for approving changes.<sup>18</sup>

Although there is a need to respect the decision of the majority, there is also a need to protect minority shareholders when their interests are under threat. Whilst the exceptions to the rule in *Musa Misango v Eria Musigire & Others*,<sup>19</sup> enable a minority shareholder to sue in the name of the company where, for instance, the majority is committing a fraud on the minority, the exceptions are not entirely useful because a shareholder is still required to discharge the onus of establishing fraud.<sup>20</sup> The protection offered to minority shareholders should be enhanced by enabling them to litigate in the name of the company without establishing, first, that there is fraud. Since minority shareholders, who claim that the conduct of directors is oppressive, are required to establish that directors have overwhelming control of the

---

<sup>17</sup>Modern courts in Australia and the U.K. still recognise the subsistence of the subjective element. See *Theodore Goddard* [1992] BCC 14.

<sup>18</sup>BR Cheffins, *Company Law: Theory, Structure, and Operation*, (Clarendon Press: Oxford, 1997), p 18.

<sup>19</sup>*Musa Misango v Eria Musigire & Others* [1966] EA 390 (applying *Foss v Harbottle* (1843) 2 Hare 461).

<sup>20</sup>Although the courts in the United Kingdom have accepted that the term 'fraud' may cover breaches of duty, intentional acts of discrimination, and unintentional abuses of corporate power, it is not certain whether Kenyan courts would adopt a similar definition. See *Knight v Frost* [1999] 1 BCLC 364.

company and that it is just and equitable to wind up the company,<sup>21</sup> their chances of enforcing the rights of the company are also limited. Such shareholders can be protected by relaxing the burden of proof required of them when the rule in *Musa Misango v Eria Musigire & Others* stands in the way of justice. Requiring shareholders to seek leave of the court before initiating proceeding can act as a safeguard against frivolous suits by shareholders because the courts would be in a position to establish their bona fides, the inaction of the company, whether the action is in the best interests of the company, and whether there is a serious issue to be tried.<sup>22</sup>

The powers of shareholders to enforce the liability of directors can be enhanced further by relaxing the inspection and investigation provisions under the Act which are at odds with the interests of shareholders.

Parastatals have contributed to the poor state of the Kenyan economy<sup>23</sup> and the indebtedness of the country to international lending agencies and western countries<sup>24</sup> due to mismanagement. The role of the State in running parastatals has been ineffective due to its failure to have adequate management controls. The lack of management controls is attributable to the politicisation of the appointment of directors by the State Corporations Act.<sup>25</sup> This statute vests the powers of appointment in the President<sup>26</sup> and the Ministers.<sup>27</sup> The statute has concentrated power in the institution of the President, hence making it unaccountable for appointing incompetent directors to head parastatals. Directors often act in the interests of their appointors rather than the corporation. In addition, the performance

---

<sup>21</sup> A shareholder is required to prove this under the statutory oppression remedy.

<sup>22</sup> These are some of the grounds that have to be satisfied before a person can get leave of the court in Australia to pursue a statutory derivative action. See s. 237 Corporation Law 2001.

<sup>23</sup> According to a World Bank report, *World Development Indicators*, released on 30 April 2001, Kenya was the only one of the 10 sub-Saharan countries with negative growth rates greater than 0.5 per cent in 1999. Although the economy of the country grew by 4.2 per cent between 1980 and 1989 and 6.5 per cent between 1970 and 1979, the growth had declined to 2.2 percent by 1993. The GDP slowed down from 2.3 per cent in 1997 to 1.8 per cent in 1998. See Redfern, "World Bank's Dim Picture of Kenya's Economy", *Daily Nation*, 1 May, 2001; "An Economy at War with Itself", *East African Standard*, 25 April, 2001; Magero and Kanani, "Concern over Large Increase in Domestic Debt", *The East African* 10 January, 2000.

<sup>24</sup> A sizeable percentage of all the country's debt is owed by parastatals. See SRI International and Mwaniki Associates, *Parastatals in Kenya: Assessment of their Impact and an Action Plan for Reform; Final Report Prepared for Kenya Association of Manufacturers*, February, 1992, pp 36, 61.

<sup>25</sup> Cap 446, Laws of Kenya.

<sup>26</sup> S 6 (1) (a), the President appoints the chairman.

of the boards of directors in parastatals is constrained by excessive regulations and extensive ministerial intervention in the functioning of the boards. These factors impair their ability to make commercially sound decisions and enforce accountability. Shortcomings can be resolved by giving directors autonomy by separating the State and parastatals. Although the Government has started the process of privatisation, it should also focus on establishing an effective regulatory framework for private companies which would ensure that the resources of privatised companies are not abused by miscreant directors.

Whilst the intervention of the State in parastatals is largely to blame for their poor performance, its intervention in the economy can be beneficial in respect of the regulation of directors. Whilst self-regulation might have the positive effect of reducing the interference of the Government in the market and the reluctance to punish miscreant directors, it is unlikely to be effective where self-regulatory authorities need to resort to the judiciary for enforcement. Other conditions which militate against self-regulation in Kenya include poor organisation of the private sector, corruption and lack of international obligations. Self-regulation is unlikely to be fruitful unless the underlying problems are solved.

In order for a regulatory framework to raise the levels of responsibility and accountability of directors, it is important to have an effective mechanism for disqualifying miscreant directors from running companies. This would have the effect of protecting the public by placing prohibitions on errant directors being involved, for a specific period, in the management of companies. Disqualification orders would also prevent people without the necessary qualifications from managing companies and serve as a deterrent to those who might be tempted to engage in fraudulent activities.

The law should ensure that directors who have been responsible for the insolvency of several companies in Kenya and other fraudulent ones are precluded from acting as directors for a specified time in order to protect companies. The period of disqualification should be long enough to serve as a deterrent and protect

---

<sup>27</sup> S 6 (1) (e), the minister appoints the Chief Executive Officer and other members of the board.

companies. The introduction of a register of disqualification would enable creditors and the general public to monitor disqualification orders with a view to ensuring that disqualified directors do not continue to act secretly.

Although a more far-reaching change is required in Kenya to develop an efficient legal system, the implementation of the recommendations for reform suggested in this thesis would go a long way towards making the regulatory framework for directors more stringent and competitive. As Wabwile notes:

"After a century of legal dependence on English law, time has come for us to reconsider this state of affairs. With over three decades of independence, Kenya's legal system has come of age. The country's legal system has to be recast afresh in a comprehensive law reform programme. Such reforms would have the tendency of delinking this country's legal system from that of England, thus opening up new space for juristic development."<sup>28</sup>

---

<sup>28</sup> Wabwile, "Reflections on the Future of the Common Law in Kenya", Law Africa p 6 <[www.lawafrica.com/Articles](http://www.lawafrica.com/Articles)>

## BIBLIOGRAPHY

### BOOKS

Ayres I and Braithwaite J, *Responsive Regulation: Transcending the Deregulation Debate* (Oxford: Oxford University Press, 1992).

Baldwin R et al, *Regulation and Public Law* (London: Weidenfeld and Nicolson, 1987)

Berle A and Means G, *The Modern Corporation and Private Property*, (New York: The Macmillan Company, 1932) [Reprint, Transaction Publishers, New Brunswick, N J, 1991].

Charlesworth & Morse, *Company Law*, Ninth edition, (London: Sweet & Maxwell, 1968).

Cheffins BR, *Company Law; Theory, Structure and Operation*, (Oxford: Clarendon Press, 1997).

Davies PL, *Gower's Principles of Modern Company Law*, Sixth Edition, (London: Sweet & Maxwell, 1997).

Dine J, *Company Law*, (Sweet & Maxwell, 2001).

Drzemczewski A, *European Human Rights Convention in Domestic Law* (Oxford University Press, 1983).

Farrar J et al, *Farrar's Company Law*, Third edition, (London: Butterworths, 1991).

Feldman D and Meisel F (eds), *Corporate and Commercial Law: Modern Developments*, (Lloyds of London Press, 1996) p 147.

Gachuki D, *The Regulation of Foreign Investment in Kenya, 1963-81: An Empirical Study* (University of Warwick, PhD Thesis, 1982).

Ghai YP and McAuslan J, *Public Law and Political Change in Kenya* (Oxford University Press, 1970).

Griffin S, *Company Law: Fundamental Principles*, Third edition, (Essex: Pearson Education Limited, 2000).

Griffin S, *Personal Liability and Disqualification of Company Directors*, (Oxford: Hart, 1999).

Griffiths & Wall, *Applied Economics: An Introductory Course*, Sixth Edition, (London and New York: Longman, 1995).

Grosh B, *Public Enterprise in Kenya: What Works, What Doesn't, and Why*, (Reinner Publishers, 1991).

Hussain A, *Company Law in Kenya*, (East African Educational Publishers, 1993).

Kibwana K et al (ed), *The Anatomy of Corruption in Kenya: Legal, Political, and Social Economic Perspectives*, (Nairobi: Claripress 1996).

Loose et al, *The Company Director*, Seventh Edition (Jordans, 1993).

OECD, *OECD Proceedings: Corporate Governance, State Owned Enterprises and Privatisation*, (Off Pubns OEEC 2781, 1998).

Ogolla J, *Company Law*, (Nairobi: Focus Publications, 1997)

Palamagamba J, *Human Rights Jurisprudence in East Africa: A Comparative Study of Fundamental Rights and Freedoms of the Individual in Tanzania, Kenya and Uganda*, (1 Aufl Baden-Baden: Nomos Verl-Ges, 1995)

Pettet B, *Company Law* (Essex: Pearson Education Limited, 2001).

Mayson S et al, *Company Law*, Seventeenth edition (London: Blackstone Press, 2000).

Mitchell L (ed), *Progressive Corporate Law* (Boulder, Colorado, 1995).

Raz J, *The Morality of Freedom* (OUP, 1986).

Sheikh S and Rees W, *Corporate Governance and Corporate Control*, (London: Cavendish, 1995).

Thomas PA, *Private Enterprise and the East African Company*, (Tanzania Publishing House Ltd, 1969).

Wheeler S (ed), *The Law of the Business Enterprise* (OUP, 1994).

Wolfson N, *The Modern Corporation: Free Markets Versus Regulation*, (New York: Free Press, 1984).

## ARTICLES

Amollo, "Judicial Reform", *The Advocate Magazine*, December 2000.

Amollo, "Reviewing 100 years of common law in Kenya", *The Advocate Magazine*, January 1999.

Baggot, "Regulatory Reform in Britain: The Changing Face of Self-Regulation", (1989) 67 *Public Administration* 435.



Bamford, "Directors' Duties: The Public Dimension", [2000] 2 *Company Lawyer* 38.

Beck, "The Saga of Peso Silver Mines", (1971) 49 *Canadian Bar Review* 80.

Berkhahn, "Derivative Action in Australia and New Zealand", (1998) 10 *Bond Law Review* 74.

Berle, "For Whom are Corporate Managers Trustees", (1932) 45 *Harvard Law Review* 1365.

Bidin, "Corporate Law Directors' Duties and Creditor Protection", [1998] 19 *Company Lawyer* 188.

Birds, "Making Directors do their Duties", [1980] *Company Lawyer* 67.

Birds, "The Permissible Scope of Articles excluding the Duties of Company Directors", (1976) 39 *Modern Law Review* 394.

Bolodeoku, "Economic Theories of the Corporation and Corporate Governance: A Critique", [2002] *Journal of Business Law* 411

Boros, "The Duties of Nominee and Multiple Directors Part 11", (1990) 11 *Company Lawyer* 6.

Bossone and Promisel, "The Role of Financial Self-Regulation in Developing Economies, (Washington DC, The WorldBank) p. 1  
<[www.worldbank.org/finance/html/self-regulation-indeveloping.html](http://www.worldbank.org/finance/html/self-regulation-indeveloping.html)>

Boyd's "Ethics and Corporate Governance: The Issues Raised by the Cadbury Report in the United Kingdom", (1996) 15 *Journal of Business Ethics* 167.

Boyle, "The Companies Act 1980 (4)", [1980] 1 *Company Lawyer* 280.

Butcher, "Directors' Duties in the Twenty-First Century: A New Beginning?", [2000] 2 *International Comparative and Corporate Law Journal* 197.

Calcutt, "Company Law Lecture - the Work of the Take-over Panel", (1990) 11 *Company Lawyer* 203.

Centre for International Private Enterprise, "Promoting Economic Reform in Africa", *Center for International Private Enterprise Publication*,  
<[www.cipe.org/ert/e04/7africa.php3](http://www.cipe.org/ert/e04/7africa.php3)>

Clark, "Unfairly Prejudicial Conduct: A Pathway Through the Maze", (2001) 22 *Company Lawyer* 170

Crutchfield, "Nominee Directors: The Law and Commercial Reality", (1991) 12 *Company Lawyer*, 136.

- Davies, "Enforcement of Directors' Duties", [1985] *Journal of Business Law* 318.
- Dine, "Disqualification of Company Directors", (1988) 9 *Company Lawyer* 213.
- Dodd, "For Whom are Corporate Managers Trustees?", [1932] 7 *Harvard Law Review* 1145.
- Donald, "Privatization: Persuading a Skeptical Public", *Center for International Private Enterprise Publication*, 2000 <[www.cipe.org/ert/e08/2across.php3](http://www.cipe.org/ert/e08/2across.php3)>
- Drake, "Disqualification of Directors-"The Red Card", [1989] *Journal of Business Law* 474.
- Fama & Jensen, "Separation of Ownership and Control", (1983) 26 *Journal of Law and Economics* 301.
- Finch, "Company Directors: Who Cares about Skill and Care?", (1992) 55 *Modern Law Review* 179.
- Flint, "Non Executive Directors' General Duty of Care and Delegation of Duty: But Do We Need a Common Law Duty of Care?", (1997) 9 *Bond Law Review* 198.
- Gray, "Reforming Legal Systems in Developing and Transition Countries", September 1997, 34, *Finance and Development* <<http://www.worldbank.org/fandd/english/abstract/0997/014a0997.htm>>.
- Griffin, "Standards of Proof Applicable to S 6 of the Company Directors Disqualification Act 1986", (1997) 18 *Company Lawyer* 24.
- Griffin, "The Characteristic and Identification of a De Facto Director", [2000] *Company Financial and Insolvency Law Review* 126.
- Hessel, "How Corporate Governance Makes Privatization Succeed", [1995] 4 *Economic Reform Today* <[www.cipe.org/ert/e18/corp\\_gov.php3](http://www.cipe.org/ert/e18/corp_gov.php3)>
- Hicks, "Advising on Wrongful Trading: Part 2", (1993) 14 *Company Lawyer* 55
- Hicks, "Directors' Liability For Management Errors," (1994) 110 *Law Quarterly Review* 390.
- Hicks, "Disqualification of Directors-Forty Years On", [1988] *Journal of Business Law* 27.
- Hicks, "Making and Resisting Disqualification Orders", (1987) 8 *Company Lawyer* 243.
- Hoey, "Disqualifying Delinquent Directors", (1997) 18 *Company Lawyer* 130.

Hornby, "The Relationship Between the Board of Directors and the General Meeting in Limited Companies", (1977) 93 *Law Quarterly Review* 569.

Instone, "The Duty of Directors", [1979] *Journal of Business Law* 221.

International Centre for Not-for Profit Law, "Self Regulation Report-Kenya", Washington DC, < <http://www.icnl.org/journal/voliss/Kenyasr.html>>

Ipp, "The Diligent Director", (1997) 18 *Company Lawyer* 162.

James, "Connecting to the Global Economy through the World Trading System", [2000] Sep-Dec *Professional Management Journal of the Institute of Certified Public Secretaries of Kenya*, at 10.

James and Ligunya, "Organisational Relationship and the Control of Parastatals in Tanzania", (1972) 5 *East African Law Review* 39

Jensen and Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure", (1976) 3 *Journal of Financial Economics*, 305.

Jowel, "The Take-over Panel: Autonomy, Flexibility and Legality", [1991] *Public Law* 149.

Kassar, "Private Sector Growth is Good News out of Africa", *Journal of Commerce*, 23 March 2000.

Katende, "Company Law in East Africa: Present and future, with particular reference to Tanzania Mainland", (1969) 2 *East Africa Law Review* 149.

Keay, "The Director's Duty to Take into Account the Interests of Company Creditors: When is it Triggered?", (2001) 25 *Melbourne University Law Review* 315.

Kent, "CSR Investment is not a Choice" *Ethical Corporation Magazine*, Issue 1, December 2001. <<http://www.ethicalcorp.com/Magazine/issue1.pdf>>

Kimberly, "The Problem of Corruption: A Tale of Two Countries (Kenya, Uganda)", [1998] 18 (12) *Northwestern Journal of International Law & Business*, 524.

Kirkpatrick et al, "The OECD Multilateral Agreement on Investment", [1998] 4 *International Trade Law and Regulation*, 124.

Lallah, "Notes on the International Covenant on Civil and Political Rights and Some of its Case Law", [1992] 18 *Commonwealth Law Bulletin* 1276.

Leigh, "Disqualification Orders in Company and Insolvency Law", (1986) 7 *Company Lawyer* 179

Longstreth, "The SEC After Fifty Years: An Assessment of its Past and Future", (1993) 83 *Columbia Law Review* 1593.

- Louw, "Making Privatization Work in South Africa", *Economic Reform Today*, Number 2, 1999 <[http://www.cipe.org/ert/e32/e32\\_05.php3](http://www.cipe.org/ert/e32/e32_05.php3)>.
- Lowry, "The Oppression Remedy: A Canadian Approach", [1991] *Journal of Business Law* 196.
- Luoga, "Duties of Company Directors in Tanzania: The Need for Legislative Reform", [1991] *East African Law Review* 247.
- McDonough, "Corporate Governance and Government Owned Corporations in Queensland", (1998) 10 *Bond Law Review* 272
- McDonough, "Proposed New Statutory Derivative Action-Does it go Far Enough?", (1996) 8 *Bond Law Review* 47.
- Moran, "Bribery and Corruption: the OECD Convention on Combating the Bribery of Foreign Public Officials in International Business Transactions", [1999] 8 (3) *Business Ethics: A European Review*, 141.
- Muchlinski, "The Accountability of Multinational Enterprises and the Right to Development: The Compensation of Industrial Accident Victims from Developing Countries", [1993] *Third World Legal Studies*, 189.
- Mutunga, "Commercial Law and Development in Kenya", (1980) 8 *International Journal of the Sociology of Law* 1.
- Nolan, "Company Lawyer Briefing; Maxwell Improper Purposes", (1994) 15 *Company Lawyer* 85.
- Paliwala, "Privatisation in Developing Countries: The Governance Issue", [2000] 1 *Law, Social Justice & Global Development Journal (LGD)* 2  
<<http://elj.warwick.ac.uk/global/issue/2000-1/paliwala.html>>.
- Paton T, "Codification of Corporate Law in the United Kingdom and European Union: The Need for the Australian Approach", [2000] 11 (9) *International Company and Commercial Law Review* 309
- Parry, "Personal Insolvency as a Restriction on Involvement in Company Management", [1999] *Insolvency Lawyer* 199.
- Prentice, "Creditors' Interests and Directors' Duties", (1990) 10 *Oxford Journal of Legal Studies* 265.
- Prentice, "Regal Hasting Ltd v Gulliver-The Canadian Experience", (1967) 30 *Modern Law Review* 50.
- Prentice, "Shareholders Actions: The Rule in Foss v Harbottle", (1988) 104 *Law Quarterly Review* 341.

Prince, "Australia's Statutory Derivative Action: Using the New Zealand Experience", (2000) 18 *Company and Securities Law Journal* 493.

Riley, "The Company Director's Duty of Care and Skill: The Case for an Onerous but Subjective Standard", (1999) 62 *Modern Law Review* 697.

Santow, "The Codification of Directors' Duties: Some Observations from an Australian Standpoint on the Joint Consultation Paper of September 1998 issued by the Law Commission of the United Kingdom", (2000) 2 *International Company and Commercial Law Review* 127.

Schlegelmilch, "WTO: Why Still No Multilateral Rules for Foreign Direct Investment", [2000] 6 (3) *International Trade Law and Regulation*, 78.

Sealy, "Reforming the Law on Company Directors' Duties", [1991] 12 *Company Lawyer* 175.

Sealy, "The Director as Trustee", [1967] *Cambridge Law Journal* 83.

Smith, "Minority Shareholders and Corporate Irregularities", (1978) *Modern Law Review* 147.

Sheikh, "Company Law for the 21<sup>st</sup> Century: Part 2: Corporate Governance", [2002] 13 (2) *International Company and Commercial Law Review* 88.

Sullivan, "The Relationship Between the Board of Directors and the General Meeting in Limited Companies," (1977) 93 *Law Quarterly Review* 569.

Wabwile, "Reflections on the Future of the Common Law in Kenya," *Law Africa*, p 6 <<http://www.lawafrica.com/Articles>>

Wako A, "On Constitutional Review", [1998] Nov-Dec *Professional Management Journal of the Institute of Certified Public Secretaries of Kenya* 5,

Wako A "The Kenya Anti-Corruption Bill 2001: Memorandum of Objects and Reasons" *Law Africa*,  
<<http://www.lawafrica.com/specials/memorandumofobjects.htm>>

Walters, "Bare Undertakings in Directors Disqualification Proceedings: The Insolvency Act 2000, Blackspur and Beyond", (2001) 22 *Company Lawyer* 290.

Walters, "Directors Disqualification: The Vice-Chancellor's Address to the Chancery Bar Association", (2000) 21 *Company Lawyer* 90.

Wedderburn, "Shareholders' Rights and the Rule in Foss v Harbottle", [1957] *Cambridge Law Journal* 194.

White, "How Should we talk about Corporations? The Language of Economics and of Citizenship", (1985) 94 *Yale Law Journal* 1416.

## CONFERENCE PAPERS

Consultative Forum for Corporate Governance in Africa Speech, Monday 30 October 2000, Nairobi, Kenya <  
[http://www.thecorporatelibrary.com/countries/kenya/consultive\\_forum.htm](http://www.thecorporatelibrary.com/countries/kenya/consultive_forum.htm)>.

“Fighting Corruption in Developing Countries and Emerging Economies: The Role of the Private Sector”, Summary of OECD Development Centre Conference; Washington DC, 22-23, February 1999.

Kihumba, "Setting Governance Policies; Codes or Regulations?" A Panel Discussion Paper Presented at the Global Conference on Corporate Governance on 10-11 July, 2000 in the Southern Connecticut State University New Haven, USA <  
<http://www.gcgf.org/library/speeches/Kihumba.doc>>.

Rev Musyimi, “Towards National Reconciliation in Kenya”, Address given to Transparency International-Kenya Open Forum on Whether Kenya should be Thinking of an Amnesty for Economic Crimes, on 26 April, 2001, at Norfolk Hotel Ballroom.  
<http://www.tikenya.org/documents/RevMutavaMusyimiSpeechOnAmnesty.doc>.

## REPORTS

Amnesty International, *1999 UN Commission on Human Rights: Making Human Rights Work: Time to Strengthen the Special Procedures Appeal Case: United States of America*, Report - AMR 51/18/99, March 1999,  
<<http://www.amnesty.org/ailib/aipub/1999/AMR/25101899.htm>>

Commission of Enquiry into the Working and Administration of the Present Company law in Ghana, *Final Report of the Commission of Enquiry into the Working and Administration of the Present Company law in Ghana*, 1961 (Professor Gower's Report).

Committee on Company Law Amendment, The Report of the Committee on Company Law Amendment, Cmnd 6659 (1945) (Cohen Report).

Committee on the Financial Aspects of Corporate Governance, *Report of the Committee on the Financial Aspects of Corporate Governance* (London: Gee, 1992). (Cadbury Report)

Committee on Corporate Governance, *Final Report of the Committee on Corporate Governance* (Gee, London, 1998) (Hampel Committee).

Committee on Insolvency Law and Practice, *Report of the Review Committee on Insolvency Law and Practice* Cmnd 8558 (1982) (Cork Committee).

Government of Kenya, *Kenya's Parastatal Reform Programme*, A document presented for discussion to the Consultative Group Meeting of Kenya's donors in Paris, November 1991.

Greenbury Committee, *Directors Remuneration: Report of a Study Group* (chaired by Sir Richard Greenbury, 1995).

Institute of Directors in South Africa, *The King Report on Corporate Governance*, 2001.

International Chamber of Commerce, *Responsible Business Conduct: An ICC Approach: Policy Statement*, 6 May 2000.

NGO Steering Committee to the UN, *The NGO Alternative Treaties: Global Forum*, Rio de Janeiro, June 1-15, 1992. <<http://www.igc.org/csngo/alttreaties/AT16.htm>

The Company Law Review Steering Group, *Modern Company Law for a Competitive Economy: The Strategic Framework*, February 1999.

The Company Law Review Steering Group, *Modern Company Law for a Competitive Economy: Developing the Framework* (URN00/656) London: DTI, 2000).

Nigeria Law Reform Commission, *Working Papers on the Reform of Nigerian Company Law: Volume 1-Review and Recommendations*, 1987.

OECD Working Party of the Trade Committee, *Codes of Corporate Conduct; An Inventory*, 1998.

Report of the Committee on the Financial Aspects of Corporate Governance (London: Gee 1992).

Republic of Kenya, *African Socialism and its Application to Planning in Kenya*, The Sessional Paper No 10 of 1965

Republic of Kenya, *Report and Recommendations of the Committee on Review of Statutory Boards*, May 1979. (Philip Ndegwa's Report)

Republic of Kenya, *The Report of the Committee on the Administration of Justice*, 1998, <<http://www.lawafrica.com/reports/go.asp?file=kwach.xml>>

Republic of Kenya, *Report of the Commission of Inquiry: Public Service and Remuneration Commission*, 1971 (Duncan Ndegwa Report).

Republic of Kenya, *The 1982 Working Party on Government and Expenditure*, 1982.

SRI International and Mwaniki Associates, *Parastatals in Kenya: Assessment of their Impact and an Action Plan for Reform, Final Report*, February 1992.

The Company Law Committee, *Report of the Company Law Committee* (1962) Cmnd 1749 (Jenkins' Report).

The Company Law Review Steering Group, *Final Report*, (DTI, 2001).

The Law Commission of New Zealand, *Company Law Reform and Restatement*, NZLC R9 (1989).

The UK Law Commission, *Shareholders' Remedies*, Consultation Paper No 142, 1996.

The UK Law Commission, *Shareholder Remedies*, (Law Com No 246, Cm 3769) London: Stationery Office, 1997).

The UK & Scottish Law Commission, *Company Directors: Regulating Conflicts of Interest and Formulating a Statement of Duties* (Law Commission Consultation Paper No 153, London: Stationery Office, 1998).

The World Bank, *World Bank Development Report*, 2002.  
<<http://www.worldbank.org/wdr/2001/>>

## **NEWSPAPERS**

*East African Standard* ([www.eastandard.net](http://www.eastandard.net))

*Daily Nation* ([www.nationaudio.com](http://www.nationaudio.com))

*Financial Times*

*Inter Press Service News Agency* (<http://www.ips.org>)

*The East African* (<http://www.nationaudio.com/News/EastAfrican/current/>)